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Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In the Matter of **DETERMINATION OF RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (PHONORECORDS IV)**	**Docket No. 21-CRB-0001-PR (2023–2027)**

NOTICE OF ERRATA FOR THE WRITTEN DIRECT AND REBUTTAL STATEMENT OF APPLE INC.

Apple Inc. ("Apple") hereby submits the following errata contained in its written submissions, filed on March 8, 2022 and April 22, 2022.

I. APPLE'S AMENDED DIRECT WRITTEN SUBMISSION

On March 8, 2022, Apple submitted an Amended Corrected Written Direct Statement. This statement was submitted when a ruling on the BMI related materials was still pending, as such Apple did not include final versions of APL-057, APL-133 and APL-134, which are agreements it has entered into with BMI. Copies of these exhibits are attached hereto.

II. APPLE'S WRITTEN REBUTTAL SUBMISSION

A. Volume 1: Introductory Memorandum

Apple makes the following amendments to its Introductory Memorandum:

Page No.	Original	Corrected
11	*Fifth*, she explains that the COs claim …	*Fifth*, she explains that the COs' claim …

B. Volume 2: Witness Statement and Expert Report

Apple makes the following amendments to the Elena Segal Rebuttal Statement:

Paragraph No.	Original	Corrected
17	…(i.e. mechanical…	…(i.e., mechanical)
17	…rather than insisting on a 50/50 split..	…rather than insisting on a 50/50 split.
28	…month if it was missing…	…month if it were missing…
28	…reduced royalty cost for…	…reduced royalty costs for…
29	… significantly threaten Apple's…	… significantly threatens Apple's…
37	…RESTRICTED…	…RESTRICTED…
49	…the discounts services…	…the discounts that services…
50	…its trials plans…	…its trial plans…
58	RESTRICTED …	…RESTRICTED…
59	…RESTRICTED…	…RESTRICTED…
82	… in home, in ear, mobile…	… in-home, in-ear, mobile…
83	… and raise competition concerns Moreover, all of these…	…and raise competition concerns. 84. Moreover, all of these…
84	It is also worth noting that…	[Paragraph removed and replaced with sentence beginning "Moreover, all of these . . . " previously in Paragraph 83.]
98	… statement at ¶ 18…	… statement at ¶ 18)…
99	…some risk: as prices…	…some risk: as prices…
131	…3,000,000 song and…	…3,000,000 songs and…
144	…APL-262 at Section 6…	…APL-134 at Section 6…

Apple makes the following amendments to the Written Rebuttal Testimony of Stephen D. Prowse:

Paragraph or Footnote No.	Original	Corrected
¶ 28	see Eisenach WDT at 5	*see* Eisenach WDT at 5
¶ 48	see **Exhibit 2**	*see* **Exhibit 2**
¶ 73	Copyright Owners' experts fail to note that under the purported complementary income	[Delete sentence/partial sentence. Capitalize 'music' in the following sentence]

	approach they propose, one must also assess the part of music revenue driven by non-music businesses. The reason is that the	
¶ 86	see **Exhibit 5**	*see* **Exhibit 5**
¶ 107	see *Section VI.A*	*see Section VI.A*
¶ 148	see *Section V.A*	*see Section V.A*
¶ 153	When negotiating with publishers,	When negotiating with Publishers,
¶ 156	Like move producers,	Like movie producers,
¶ 206	[Section C header]. Publishers' Have Significant Profits	Publishers Have Significant Profits
Footnote 7	see **Exhibit 2**	*see* **Exhibit 2**
Footnote 10	The different Copyright Owners' experts are not consistent in their terminology. Eisenach uses the term	The different Copyright Owners' experts are not consistent in their terminology. Eisenach uses the term 'complementary' income; Watt uses the term 'parallel' or 'displaced' income.
Footnote 12	Prowse WDT ¶22; *also see* Apple Proposal, §385.2 and §385.21(b)(3)(ii)."	"Prowse WDT ¶22; *also see* Apple Proposal, §385.2 and §385.21(b)(3)(ii) in Apple's Amended WDS."
Footnote 24	under the CO's proposal	under the COs' proposal
Footnote 37	Vol. 2, Hurwitz ¶ 12.	Hurwitz WDT ¶ 12.
Footnote 38	Vol. 2, Hurwitz ¶ 13.	Hurwitz WDT ¶ 13.
Footnote 39	Vol. 2 Kaeffer ¶ 17.	Kaefer WDT ¶ 17.
Footnote 40	Vol. 2 Kaeffer ¶ 19	Kaefer WDT ¶ 19.
Footnote 41	Pandora White ¶41.	White WDT ¶41.
Footnote 42	Pandora WDT, Herring *Phono III* (892:20-894:8).	Herring *Phono III* WDT (transcript attached: 892:20-894:8).
Footnote 45	*See, e.g.*, Google Vol. 2, Higginson ¶¶ 97, 99; Spotify Vol. 2, Bonavia ¶¶ 52-55.	*See, e.g.*, Higginson WDT ¶¶ 97, 99; Bonavia WDT ¶¶ 52-55.
Footnote 46	See	*See*
Footnote 47	See, e.g. Amazon Vol. 2, Hurwitz ¶ 51	*See, e.g.,* Hurwitz WDT ¶ 51
Footnote 48	See	*See*
Footnote 50	See	*See*
Footnote 53	The other extreme	The other approach
Footnote 57	Spotify Vol. 2, Kaefer ¶62.	Kaefer WDT ¶ 62.

Footnote 63	*See, e.g.*, Pandora White ¶ 45.	*See, e.g.*, White WDT ¶ 45.
Footnote 67	Kaefer WDS ¶20. [fn omitted]	Kaefer WDT ¶20. [fn omitted]
Footnote 68	Kaefer WDS ¶20.	Kaefer WDT ¶20.
Footnote 69	Kaefer WDS ¶13. [fn omitted]	Kaefer WDT ¶13. [fn omitted]
Footnote 71	Segal (Amended WDS) ¶130.	Segal (Amended WDT) ¶130.
Footnote 72	Bonavia WDS ¶43.	Bonavia WDT ¶43.
Footnote 73	Bonavia WDS ¶¶43-45.	Bonavia WDT ¶¶43-45.
Footnote 75	See	*See*
Footnote 85	See	*See*
Footnote 87	Segal WDT at ¶120	Segal WDT ¶120.
Footnote 88	See	*See*
Footnote 91	The December 9, 2021, Order describes this process.	Notice and Sua Sponte Order Directing the Parties to Provide Additional Materials, In re Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), Docket No. 16-CRB-0003-PR (2018-2022) ("the December 9, 2021 Order") describes this process.
Footnote 102	White WRT, ¶4-5	White *Phono III* WDT (remand) ¶4-5.
Footnote 104	Mirchandani WST, ¶14.	Mirchandani *Phono III* WST, ¶14.
Footnote 110	Flynn cites the Hawkfire study at ¶90,	Flynn cites the Hawkfire study at ¶90 (COEX-8.116, part of Copyright Owners' WDS, Volume VI.G and Amazon Exhibit 20),
Footnote 119	*See* Apple's Response to Interrogatories #3, 11/18/21.	*See* Apple's Response to First Set of Interrogatories #3, 11/18/21.
Footnote 122	Herring WDS ¶54.	Herring WDT ¶54.
Footnote 138	Google WRT Levine ¶¶8-9 ["These claims about Google are unequivocally unfounded. To assert that Google plans to use Google Play Music, a service with only around 1.5 million subscribers in the U.S., to "gro[w] [its] base of customers to whom [it] can then market [its] other products and services" is absurd on its face.7 It is	Levine *Phono III* WRT ¶¶8-9 ["These claims about Google are unequivocally unfounded. To assert that Google plans to use Google Play Music, a service with only around 1.5 million subscribers in the U.S., to "gro[w] [its] base of customers to whom [it] can then market [its] other products and services" is absurd on its face. It is public knowledge that Google's other products already reach literally hundreds of millions of people in the U.S. The idea that Google is intentionally driving down the price of Google Play Music in order to "grow a base of customers" who will then be more likely to use Search or GMail or Google Maps simply strains credulity. The value proposition flows in the

	public knowledge that Google's other products already reach literally hundreds of millions of people in the U.S.8 The idea that Google is intentionally driving down the price of Google Play Music in order to "grow a base of customers" who will then be more likely to use Search or GMail or Google Maps simply strains credulity. The value proposition flows in the opposite direction. Google Play Music is marketed to a far wider net of possible subscribers because of Google's brand and the reach of Google's other products.9 Google's addressable market for Google Play Music is greatly enhanced by the massive market penetration of Google's other products and services."]; Amazon, Hurwitz WDS ¶ 19-2 0, 28.	opposite direction. Google Play Music is marketed to a far wider net of possible subscribers because of Google's brand and the reach of Google's other products. Google's addressable market for Google Play Music is greatly enhanced by the massive market penetration of Google's other products and services."]; Amazon, Hurwitz WDS ¶ 19-20, 28. [footnotes omitted]
Footnote 140	Eisenach WDT ¶66 [fn omitted]	Eisenach WDT ¶66. [fn omitted].
Footnote 171	Watt WDT Table 5. These percentages correspond to q values of 0.1, 0.2 and 0.3 respectively.	Watt WDT Table 5. These percentages correspond to q values of 0.1, 0.2 and 0.3, respectively.
Footnote 173	*Phono III* Watt WRT Table 1and ¶34.	Watt *Phono III* WRT Table 1 and ¶34.
Footnote 174	*Phono III* Watt WRT ¶34.	Watt *Phono III* WRT ¶34.
Footnote 179	Exhibit 186 (Exhibit B at p. 43 has the rates);	Exhibit 186 (APL_PHONO_00004529 – 639) (Exhibit B at p. 43 has the rates); Apple's

	Apple's Amendment with UMG was dated 12/23/08 Exhibit 187 (Exhibit C-1 at p. 1 has the rates); Apple's Amendment with Warner was dated 12/19/08. Exhibit 189 (rates are on p. 4).	Amendment with UMG was dated 12/23/08 Exhibit 187 (APL_PHONO_00004814 – 844) (Exhibit C-1 at p. 1 has the rates); Apple's Amendment with Warner was dated 12/19/08. Exhibit 189 (APL_PHONO_00005334 – 345) (rates are on p. 4).
Footnote 195	See…See also	*See…See also*
Footnote 205	See…See also	*See…See also*
Footnote 213	Eisenach WDT ¶102 .	Eisenach WDT ¶102.
Footnote 217	See	*See*
Footnote 218	See	*See*
Footnote 232	Copyright Owners touted that the headline rate was a 44% increase after the *Phono III* Final Determination [cite]	Copyright Owners touted that the headline rate was a 44% increase after the *Phono III* Final Determination. *See, e.g.,* Ian Courtney, "Copyright Royalty Board Starts the Final Countdown for New Mechanical Rates," Celebrity Access 2/5/19 (quoting David Israel of the NMPA). https://celebrityaccess.com/2019/02/05/copyright-royalty-board-starts-the-final-countdown-for-new-mechanical-rates/. [last accessed 4.22.22]
Footnote 235	Kelly para 11 (footnote omitted) [emphasis added].	Kelly para 11 (footnote omitted). [emphasis added]

Updated versions of the Elena Segal Rebuttal Statement and Written Rebuttal Testimony of Stephen D. Prowse are attached to this submission.

C. Volume 3: Exhibits

Apple hereby withdraws APL-244 and APL-262, which are duplicates of APL-133 and APL-134, respectively. The attached exhibit list is updated to reflect this withdrawal.

Dated: May 3, 2022

Respectfully submitted,

/s/ Dale M. Cendali

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APL-057
RESTRICTED - Filed Under Seal

APL-133
RESTRICTED - Filed Under Seal

APL-134
RESTRICTED - Filed Under Seal

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In the Matter of **DETERMINATION OF RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (PHONORECORDS IV)**	**Docket No. 21-CRB-0001-PR (2023–2027)**

INTRODUCTORY MEMORANDUM TO THE
WRITTEN REBUTTAL STATEMENT OF APPLE INC.

Pursuant to 17 U.S.C. § 803(b)(6)(C) and 37 C.F.R. § 351.4, Apple Inc. ("Apple") hereby submits this Introductory Memorandum in support of its Written Rebuttal Statement in the above-captioned proceeding.

I. SUMMARY OF POSITION

The Copyright Owners' ("COs") one-sided rate proposal does not satisfy the willing buyer willing seller standard ("WBWS"). It departs drastically from RESTRICTED [redacted], and increases interactive streaming costs to levels at which no interactive streaming service could hope to develop a healthy, sustainable, interactive streaming business.

As discussed below, the economic theories underlying this proposal are shaky at best. *First,* the COs rely on allegations that services benefit from complementary revenue generated by interactive streaming that not only lack evidentiary support, but are inconsistent with the record. *Second*, they present a grossly misleading picture of publisher and songwriter finances that leaves out at least one crucial detail: the performance royalties that interactive streaming generates for publishers and songwriters. *Third*, they advocate for a 2.5:1 ratio of sound

recording to musical works royalties that has no place in this proceeding given the *actual agreements* with publishers and Performing Rights Organizations ("PROs") for the very rights at issue in this case (mechanical rights) or perfect complements (performance rights). The ratio is also wildly inconsistent with the ratio for comparable products, and the Shapley analysis supporting it rests on little more than a series of baseless assumptions.

The Judges should reject the COs' proposal and, instead, adopt Apple's moderate approach, derived from RESTRICTED for the relevant rights and a proper balancing of the interests, needs, and finances of both services and COs (including the songwriters they serve).

A. The Copyright Owners Propose a Drastic Increase In Mechanical Royalties That Does Not Satisfy the Willing Buyer Willing Seller Standard

Three years ago, RESTRICTED Segal WDT ¶¶ 116–126. RESTRICTED

In just the past few months, Apple renewed its Apple Music license agreements with the PROs that license performance rights on the publishers' and songwriters' behalf. These agreements have RESTRICTED

RESTRICTED

APL-249; APL-243; APL-250; APL-025. These too were heavily negotiated agreements for the performance right, a perfect complement to the mechanical right.

Yet now despite this, the same publishers that RESTRICTED and whose interests the PROs represent, propose ***significantly higher*** rates—***20% of revenue*** and ***no adjustments*** for family plans, student plans, limited functionality plans, trials, or bundles. Through the percentage of revenue prong, the services want to benefit from any upside the services create, but refuse to participate in making growth possible through discounts and rates for non-premium plans. The proposal also includes a TCC prong, mechanical-only per-subscriber minimum, and a mechanical-only per-play rate ***in addition to*** the revenue prong, with each prong functioning to drive rates higher. There is no need for such duplication; a single minimum, such as a per-subscriber rate RESTRICTED, sufficiently protects COs from revenue deferral and displacement concerns. The TCC prong is particularly redundant, REST Therefore, the TCC prong is RESTRICTED

The COs' proposal would result in a more than RESTRICTED increase in Apple's mechanical royalties RESTRICTED in 2020,[1] and an overall royalty obligation of at least RESTRICTED, for musical works and sound recording rights combined. Segal WRT ¶¶ 13, 22, 23.

RESTRICTED

[1] *Compare* APL-2 at 3 (showing mechanical royalties of approximately RESTRICTED of revenue in 2020) to Segal ¶ 13 (RESTRICTED under COs' proposal).

[redacted] *Id.* ¶ 4. Indeed, even under current margins, [redacted]. Contrary to the COs' suggestion, raising prices does not help [redacted] for new features and promotions to attract consumers to the higher-priced service. Indeed, [redacted].

There can be no doubt that the COs' proposal does not satisfy the WBWS standard, as no service in a reasonably competitive marketplace would agree to it, nor have they in the past. The rates are too high, and the lack of adjustments to minima and bundled revenue will only hurt the interactive music streaming industry, COs, and services alike.

B. The Economic Theories the COs' Offer to Support Their Rate Proposal Are Highly Speculative

Lacking any comparable agreements that support their proposal, the COs resort to speculation. They attempt to justify higher rates by claiming, without proof, that companies use their interactive music streaming services to promote their non-music business lines. Apple does not do this. Indeed, the argument is nonsensical when you consider that Apple makes Apple Music available on numerous *non-Apple* devices. Segal WRT ¶ 71.

Rather than interactive music streaming driving revenue for non-music products, it is the exact opposite. Apple's innovative devices and high-quality hardware facilitate the growth in interactive music streaming by making it easier and more enjoyable for consumers to listen to music from various services (not just Apple's) in all aspects of their lives. Moreover, the benefits to COs do not end there. Apple's devices and hardware also promote the use of *other*

entertainment services that generate revenue for COs, such as television, fitness apps, social media, non-interactive streaming, and internet radio.

For all their talk about complementary revenue, the COs forget that complementarity can go both ways. It is not reasonable to demand interactive streaming services pay heightened royalties because COs *speculate* that music drives some small fraction of revenue to non-music business lines, while ignoring the myriad ways in which the companies in this proceeding help COs generate income through other offerings at no cost to the COs. Indeed, the companies in this proceeding make portable devices, headphones, in-home smart speakers, easy-to-use interfaces, operating systems, and many other technological innovations that contribute to the growth in COs' revenues without any added investment by the COs.

Setting rates based on unproven theories about complementary revenue also has the pernicious effect of shutting non-diversified companies out of the interactive streaming market. While companies should not have to use their non-music income to fund their music businesses, non-diversified companies likely *cannot* afford to pay such rates.

The COs offer several other unsupported theories to justify their dramatic rate increase. *First*, they claim information asymmetries pervade negotiations between services and rightsholders because services have information about complementary revenue. But again, there is no evidence of this supposed complementary revenue and, in any case, as Apple's expert Dr. Stephen Prowse explains, rightsholders also have information services do not. Information asymmetries are not one-directional. Prowse WRT ¶¶ 105–106. *Second*, the COs claim that the Judges must set rates at the high end of reasonableness based on the theory that the statutory rates act as a ceiling and that the parties can negotiate lower rates if the statutory rate is too high. As an initial matter, the COs' proposal is not within the zone of reasonableness, so this argument

is irrelevant. Moreover, Apple's [redacted]. Segal WRT ¶ 107. Indeed, it is highly unlikely that the COs would voluntarily agree to rates lower than the statutory rates when they know that any such agreements would be introduced as WBWS evidence in the next rate-setting proceeding. Setting rates with the expectation that services and publishers will negotiate lower ones also undermines the purpose of the blanket license under the Music Modernization Act, which was designed to improve efficiencies and reduce transaction costs. *Third*, the COs further suggest, without proof, that labels will lower rates in response to an increase in musical works royalties. [redacted]. Segal WRT ¶ 26.

C. The COs' Description of Publisher and Songwriter Finances Is Skewed and Misleading

In addition to speculative economic theories, the COs rely on a grossly misleading presentation of publisher and songwriter finances to support their position. The COs suggest that mechanical royalties from interactive streaming must offset the entire decrease in mechanical royalties from downloads and physical sales over the past ten or so years for publishers and songwriters to survive. This is an extremely narrow and deceptive view.

Interactive streaming generates two types of royalties for publishers and songwriters: mechanical and performance. The publishers' own data shows [redacted]

	Change in Mechanicals from Physical and Downloads	Change in Royalties from Interactive Streaming	Net
Sony Music Publishing (2009 v. 2020)	RESTRICTED	[redacted]	[redacted]
UMPG (2009 v. 2020)	RESTRICTED	[redacted]	[redacted]
Warner/Chappell (2009 v. 2019)[2]	RESTRICTED	[redacted]	[redacted]

Prowse WRT ¶¶ 190–194. This suggests that, contrary to the COs' claim, royalty rates over the past few years have been more than enough to compensate COs.

In addition, many internet-based services other than interactive streaming also substitute for downloads and physical [redacted] Klein Table 37. [redacted] *Id.* Spotify's expert, Prof. Hauser, found that if consumers could no longer use Spotify, only 31.7% believe they would purchase new music. Hauser Appendix T. By contrast, 67.3% would listen to music via online video sites, 60.7% would listen to some form of non-interactive streaming, and 55.2% would listen to AM/FM or Internet radio. *Id.* These numbers suggest that many forms of music consumption substitute for purchasing music, as consumers would choose these other activities before purchasing music if they could not stream on demand. Therefore, interactive streaming alone should not be expected to substitute for all losses in mechanical royalties from consumers shifting away from a music ownership model.

[2] Warner/Chappell did not provide complete data for 2020.

The COs' position also loses sight of the big picture. [redacted] from sync licenses for fitness apps, social media, and video-streaming services that the diversified companies in this proceeding facilitate. Prowse Decl. ¶ 206. [redacted] *Id*. ¶ 207. By contrast, [redacted] Segal WDT ¶¶ 50, 59. A proposal that takes revenue from interactive streaming services, [redacted], and gives it to publishers, whose profits have [redacted] makes no sense and seriously threatens the long-term viability of a healthy interactive streaming marketplace.

Finally, the COs present testimony suggesting that the songwriting industry might not survive without an increase in mechanical royalties. This hyperbolic testimony stems from the extremely narrow view of royalties just described. Songwriters focus on mechanical royalties from interactive streaming with only passing reference (at best) to the many other royalties they earn. It is not possible, however, that publishers' royalties soared the past few years, but songwriters' royalties did not. To the extent an individual songwriter's royalties may have decreased, this could be due to many things—the lack of popularity of the songwriter's songs in this era where songwriters are compensated for plays, rather than for having songs on an album; the increase in collaboration that publishers encourage, which results in more songwriters sharing royalties from any given song; or more songwriters creating and sharing music, as barriers to entry decrease. None of this means interactive streaming services should pay higher royalties.

The COs' real concern seems to be that certain ways of doing business are becoming outdated, e.g., recouping advances largely from mechanical royalties; placing songwriters' songs

on albums to generate revenue regardless of consumers' willingness to listen; and working with a publisher at all rather than introducing music to the public directly, without an intermediary. But the music industry is thriving. Interactive streaming services should not have to pay higher royalties to subsidize the publishing industry's old way of doing business.

D. The COs' 2.5:1 Ratio of Sound Recording to Musical Works Royalties Is Inappropriate For Establishing Rates under the WBWS Standard

To establish a rate level, the COs use the rates in label agreements and then apply a 2.5:1 ratio of sound recording to musical works royalties. As an initial matter, the COs' ratio model has no place here. The Judges must apply a WBWS standard. There is no reason to create a ratio when actual agreements demonstrating WBWS rates—RESTRICTED the *Phonorecords II* settlement—exist. No agreement produced in this proceeding has the mechanical royalty rate the COs propose here.

If the Judges were nonetheless to look to a ratio for guidance, however, they should not use 2.5:1. Market evidence shows that the ratio in the interactive streaming space, and the related download space, RESTRICTED its PRO agreements range from RESTRICTED to RESTRICTED, and download rates range from RESTRICTED to RESTRI. Prowse WRT ¶ 127.

The COs rely on a Shapley analysis to support their ratio, but Shapley models are not suited to establishing WBWS rates. As Apple's expert Dr. Stephen Prowse explains, a Shapley analysis is only as good as its inputs and, here, the various inputs (e.g., costs, number of players) are very difficult to determine precisely. Professor Watt makes numerous assumptions to build his model. Consequently, the results are just that: an assumption. Professor Watt's model also erroneously relies on the COs' one-sided complementary revenue theory, which skews all of his results.

The COs also attempt to use the ratio in audiovisual licenses to support the 2.5:1 ratio. The Judges already rejected this approach in *Phonorecords III* given the "lack of comparability" between the synch market and interactive streaming. *Phonorecords III*, at 1941. Nothing has changed. Unlike interactive streaming services, fitness apps, social media apps, and other purchasers of synch licenses do not need the full catalog of labels' songs to survive, and could create cover songs because consumers do not use these apps to hear specific recordings. Thus, there is more competition among labels in the audiovisual market than in the interactive music streaming market.

II. SUMMARY OF WRITTEN REBUTTAL TESTIMONY

A. Fact Witness: Elena Segal

Elena Segal has worked for Apple in connection with music licensing matters for over 20 years. She is currently the Global Senior Director of Music Publishing at Apple, a position she has held for two years. Her testimony focuses on the following main issues.

First, she explains the extreme impact that the COs' proposed rates would have on Apple Music, raising its musical works royalty obligation to over RESTRICTE of revenue. Of course in the real world, services also have to pay sound recording royalties, thus raising total royalties to over RESTRICTE and, in some months, more than RESTRICTED of revenue. She explains that with royalty rates this high, it will be very difficult, if not impossible, to create a sustainable, healthy interactive streaming ecosystem of paying music consumers.

Second, she explains why the COs' failure to include (a) discounts to per-subscriber minima for family, student, and limited functionality plans, (b) royalty-free trials, or (c) adjustments to the calculation of revenue from bundles harms the interactive streaming industry. As she explains, these offerings help increase subscribership and improve revenues and royalties by attracting consumers to interactive streaming who might not otherwise pay for music.

Third, she addresses the COs' claims that Apple uses music to promote non-music business lines and underprices music as part of a loss leader strategy. She explains that Apple does not use music to drive revenue to Apple's hardware, devices, or other non-music products. To the contrary, Apple's investment in marketing, research and development, and high-quality listening experiences in all facets of consumers' lives is intended to, and does, help attract consumers to a variety of music services, to the COs' benefit.

Fourth, she describes the financial state of the music industry and the COs' various income streams. She explains that the COs' narrow focus on mechanical royalties from interactive streaming in discussing publishers' and songwriters' financials is misleading because they earn many other forms of revenue, including performance royalties from interactive streaming.

Fifth, she explains that the COs' claim that the statutory royalty rate should be set at the high end of reasonableness is wrong, as this creates numerous inefficiencies that the Music Modernization Act was designed to correct.

Sixth, she describes several terms that the COs include in their proposal that are not practical from a business perspective.

Finally, she shows that [redacted]

B. Expert Witness: Dr. Stephen Prowse

Dr. Stephen Prowse is the Senior Managing Director in the Forensic and Litigation Services Practice at FTI Consulting, Inc. ("FTI"). Before joining FTI, he was a Principal

(Partner) in the Dallas office of the Forensic Practice at KPMG LLP and a Director at PricewaterhouseCoopers LLP. Prior to his consulting career, he was employed by the Federal Reserve Bank of Dallas as a Senior Economist and Policy Advisor (1994-1998), and by the Board of Governors of the Federal Reserve System in Washington DC (1989-1994) as an Economist. Dr. Prowse has served as an expert witness in hundreds of cases. His work has included determining royalty rates and other terms for licensing agreements, damages calculations in intellectual property matters, pricing studies to evaluate whether alleged antitrust violations resulted in increased prices to consumers, estimating price elasticities of demand and supply using econometric and statistical methods, and analyzing markets in competitive, monopolistic and oligopolistic environments.

Dr. Prowse received his B.A. in economics from Cambridge University, Cambridge, England, in 1982; his M.S. in economics from the California Institute of Technology in 1984; and his Ph.D. in economics from the University of California at Los Angeles in 1989. He is also a CFA Charterholder and a member of the Licensing Executives Society. He served as an Adjunct Professor at the Cox School of Business, Southern Methodist University (1998), where he taught economics and finance, and currently serves as a guest lecturer in these subjects.

Dr. Prowse's testimony first reiterates his position that Apple's rate proposal is economically reasonable and satisfies the WBWS standard. He next explains that the COs' proposal, by contrast, is not economically reasonable and does not satisfy the WBWS standard. The proposed rates are too high and RESTRICTED [redacted].

Dr. Prowse next explains that three key theories underlying the COs' rate proposal are speculative and inconsistent with the evidence. *First*, the evidence shows that the COs' theory

that sound recording royalties will decrease if mechanical royalties increase is wrong. *Second*, he explains the lack of evidence supporting the COs' theory that interactive streaming creates complementary revenue for services. *Third*, he explains that the COs' argument about asymmetric information does not support higher mechanical royalties.

Dr. Prowse then considers the COs' 2.5:1 ratio. He explains that there are reasons to question the use of a ratio at all given the market benchmarks that already exist. He also explains that, to the extent the Judges use a ratio, a 2.5:1 ratio is too low. *First*, RESTRICTED [redacted] *Second*, he shows that the Shapley analysis the COs use to support the ratio relies on far too many assumptions to be reliable. The Shapley model is not well-suited for creating market rates. *Third*, he explains that the audiovisual licenses, and other benchmarks, on which the COs rely are irrelevant. Audiovisual works are too different from interactive streaming to be informative.

Next, Dr. Prowse considers some additional theories the COs propose concerning the impact of the WBWS standard, risk tolerances, and regulatory lag. He concludes that none of these arguments are well-founded.

Finally, Dr. Prowse analyzes publishers' financials and determines that, RESTRICTED [redacted]

Dated: April 22, 2022

Respectfully submitted,

/s/ Dale M. Cendali

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Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In the Matter of DETERMINATION OF RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (PHONORECORDS IV)	**Docket No. 21-CRB-0001-PR (2023–2027)**

ELENA SEGAL REBUTTAL STATEMENT

I. INTRODUCTION

1. My name is Elena Segal. As explained in my Written Direct Testimony, I am the Global Senior Director of Music Publishing at Apple UK Limited, an Apple Inc. ("Apple") affiliate, a position I have held for more than 2 years. Prior to that, I was the Global Director of Music Publishing for approximately one and a half years. Before that, I was the Director, iTunes International in the Legal Department ultimately with responsibility across music, video, books and the App Store outside the United States. That included extensive experience handling complex music publishing matters for iTunes and subsequently the licensing of the rights in musical compositions for the launch of Apple Music. In total, I have been employed by Apple, or an Apple affiliate, for over 16 years.

2. I submit this statement in response to the Copyright Owners' ("COs") Written Direct Statement and proposed rates and terms in this proceeding.

3. I have reviewed the COs' proposed rates and terms for mechanical royalties for interactive streaming for the period 2023-2027. I believe this proposal would only hurt the music industry—including creators—as it would make it very difficult, if not impossible, for companies, like Apple, to continue offering an interactive streaming service. The problems with

the COs' proposal include the following, each of which are discussed in greater detail in this statement:

(i) It seeks an unprecedented increase in royalties that would result in Apple paying more than 90% of its gross revenues from interactive streaming in total music royalty costs.

(ii) It proposes a 300% increase in the minimum payment for the mechanical right per individual plan, while remaining silent on performing right royalties in which the COs also have a commercial interest and which are necessary for the same uses of the same musical works and copyright as licensed here.

(iii) It includes no adjustments to minima for family plans, student plans, or offerings with limited functionality, all of which help grow the market for interactive streaming and paid music consumption, to the benefit of both COs and songwriters.

(iv) It includes no zero-royalty period for trials, which are critical to drawing consumers to paid interactive streaming services.

(v) It includes no adjustment to revenue for bundles, which reduces the incentive to include interactive music streaming in bundles and does not reflect the market reality that some consumers are drawn to bundles for the music product whereas others are drawn to bundles because of non-music components of the bundle, and RESTRICTED

(vi) It includes an overly complicated web of payment prongs, including an uncapped TCC prong, which unjustifiably ties publisher royalties to label royalties.

(vii) It proposes an increased revenue share for the COs, which disincentivizes companies' investments in their own services by reducing their margins and fails to incentivize COs to invest in the distribution of their own music and in the growth of subscription revenue, notwithstanding that such investment and growth would benefit COs and songwriters.

4. The resulting potentially negative margins for services could force them to, at best, reduce or cease investment in growth, and, at worst, discontinue operations, ending and perhaps reversing the current period of unparalleled revenue growth for COs and creators. This is particularly so given the very high percentage of revenue prong and TCC , which both cause royalties to increase in proportion to any increase in the retail price of the service (RESTRICTED

RESTRICTED), and so make it impossible to improve operating margins. In other words, services have to pay operating costs out of what is essentially a fixed share of revenue and, even under current rates, RESTRICTED

5. Marketing the service, providing new content, and developing new features, all of which are necessary to attract new subscribers and keep existing ones engaged with the service, increase costs further. Decreasing the services' revenue share through higher percent of revenue prongs likewise decreases the services' incentive to grow, which is not good for COs or songwriters. Perhaps the COs made this proposal with the expectation that the Judges will compromise off the COs' unreasonably high position and multiple price floors, but that does not serve the process well. As I understand it, the Judges are supposed to adopt rates and terms that satisfy a willing buyer/willing seller ("WBWS") test. Apple would never accept the COs' proposal in real world negotiations. The COs must know this, as RESTRICTED

6. The COs also premise their proposal on several unrealistic and misleading positions. The crux of their argument seems to be that mechanical royalties from interactive streaming should alone substitute for all losses in income from downloads and physical sales (as well as other attenuated income streams, like television and concert tours), and that services should increase mechanical royalty payments in connection with interactive streaming because

they have very profitable non-music business lines. As described below, both this narrow focus on mechanical royalties from interactive streaming and the COs' speculation about complementary revenue are grossly out-of-step with the actual market.

7. A one-sided proposal to which no interactive streaming service would agree is not helpful in achieving a result that satisfies the WBWS test. By contrast, Apple's sensible proposal, premised on actual agreements between publishers (or their representatives) and services promotes the interests of both COs and services and satisfies the WBWS test.

8. Specifically, Apple proposes a rate structure RESTRICTED [redacted] namely:

(i) For all offerings except hardware bundles, the greater of a percentage of revenue and a per-subscriber minimum, with adjustments to minima for family plans and student plans, adjustments to the calculation of revenue for service bundles, adjustments to the minima for Apple's limited functionality Voice plan (and other limited functionality plans),[1] and free trial periods.[2]

(ii) For hardware bundles, a per subscriber minimum, with no revenue prong, to account for the difficulty in allocating revenue between the one-time hardware purchase and the recurring music purchase.

9. For the particular rates, Apple proposes using the headline percentage of revenue adopted in the *Phonorecords III* remand proceeding and the per subscriber minima from the *Phonorecords II* settlement to which COs and services previously agreed and which the Judges chose to continue in *Phonorecords III*.

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[1] RESTRICTED [redacted].

[2] In this proceeding, Apple proposes a zero-royalty rate for 90 days per subscriber per three-year period, which days may be non-consecutive. RESTRICTED [redacted] to improve relations with artists and songwriters. Labels agreed to RESTRICTED [redacted]

10. As Apple's proposal RESTRICTED for interactive streaming, I believe that, unlike the COs' proposal, Apple's proposal reflects the WBWS standard and is the most appropriate proposal in this proceeding for properly balancing the interests of services and COs.

11. This statement proceeds by, first, breaking down the extreme impact that the COs' proposed rates would have on Apple Music. Second, I explain why the COs' failure to include discounts to per-subscriber minima, royalty-free trials, or adjustments to the calculation of revenue from bundles is harmful to the interactive streaming industry, COs and services alike. Third, I address the COs' claims that Apple uses music to promote non-music business lines and underprices music as part of a loss leader strategy, both of which I understand the COs use as justification for their large rate increase. Fourth, I explain why the COs' narrow focus on mechanical royalties from interactive streaming in discussing publishers' and songwriters' financials is misleading. Fifth, I address the COs' claim that the statutory royalty rate should be set at the high end of what is reasonable. Sixth, I address several definitions and terms that the COs include in their proposal that are not practical. Finally, I explain the lack of support for the COs' proposal RESTRICTED

II. THE COS' PROPOSED RATES WOULD BE VERY HARMFUL TO APPLE'S MUSIC BUSINESS

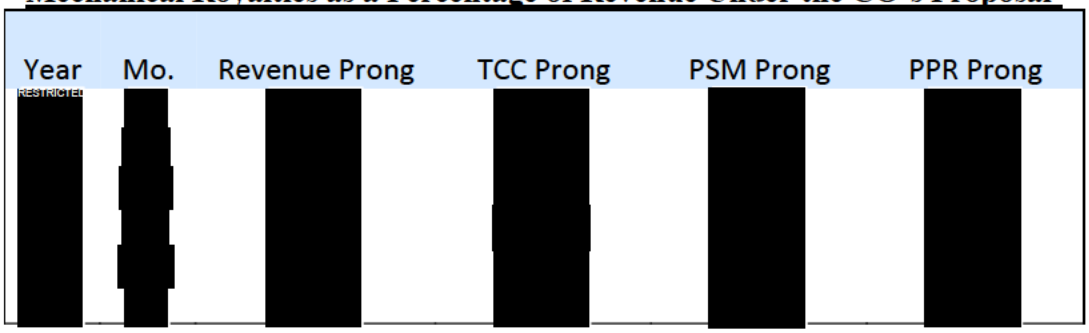
12. The COs propose a drastic increase in mechanical royalties. Under these rates, it will be impossible to RESTRICTED . The COs' proposal could force companies to choose between divesting their services or subsidizing them through revenue earned in other parts of their business, which would be harmful to competition and innovation.

A. The COs' Rate Proposal Would Lead to an Unsustainable Increase in Apple Music's Cost of Goods

13. The COs propose an estimated [redacted] increase in mechanical royalties as a percentage of revenue [redacted], *without even factoring in* the lack of royalty-free trial periods in the COs' proposal.[3]

14. The table below summarizes the percent of revenue Apple would have paid in ***mechanical royalties only***, not including performance royalties, through the first half of 2021 under each prong of the COs' proposal, calculated in aggregate. And again, these calculations understate the true impact of the COs' proposal because they do not include data for free trial periods.

Mechanical Royalties as a Percentage of Revenue Under the CO's Proposal[4]



15. This data shows that under the COs' proposal, Apple would pay, on average, approximately [redacted] of revenue in mechanical royalties per month. This data is significant for several reasons.

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[3] *Compare* APL-2 at 3 (showing mechanical royalties of approximately [redacted] of revenue in 2021 [redacted]) to [redacted] under the COs' proposal. While Apple used 2021 data to calculate its estimated royalties under the COs' proposal, it does not anticipate this would make a significant difference for purposes of the comparison. Whether 2020, 2021, or any other year, the point is that the increase is large.

[4] Calculations attached as Appendix A.

16. *First*, it shows that the COs' proposal is drastically higher than what publishers and PROs have negotiated in real-world agreements. As shown below, the COs' proposed mechanical royalty is more than *three times* the performance royalty rate to which PROs agreed on behalf of COs, even though performance and mechanical rights are perfect complements in interactive streaming.

Comparison of Performance Royalties vs Mechanical Royalties under the COs' Proposal

Year	Mo.	Revenue	Performance Royalties	Perf Royalty as % of Revenue	Mech Royalty as % of Revenue	
RESTRICTED						

17. Further, under the COs' proposal, Apple's combined musical works royalties (i.e., mechanical and performing rights in aggregate) would have been over RESTRICTED —and that would only be if PROs agreed to renew at their current rates rather than insisting on a 50/50 split.

18. To put this number in perspective, Apple's musical works royalties were approximately [redacted] of revenue in 2020 [redacted]

19. Even on a prong-by-prong basis, the dramatic increases over [redacted] are clear. The headline rate the COs propose is approximately [redacted] vs. 20%) and the mechanical-only per-subscriber floor the COs propose is [redacted]. Further, [redacted]

20. *Second*, Apple's analysis shows that despite the extremely high percent of revenue prong, Apple [redacted] under the COs' proposal, even though its dominant service is a market-standard $9.99 individual subscription. In other words, even though this per-subscriber floor is supposed to be a backstop to protect against revenue deferral and displacement (e.g., by underpricing the competition to gain market share), it is here being used to simply increase the effective rate on market-standard plans, apparently in an effort to force services to raise their retail prices (the problems with which are discussed above), and perhaps to distract the Judges from the true costs of their proposal.

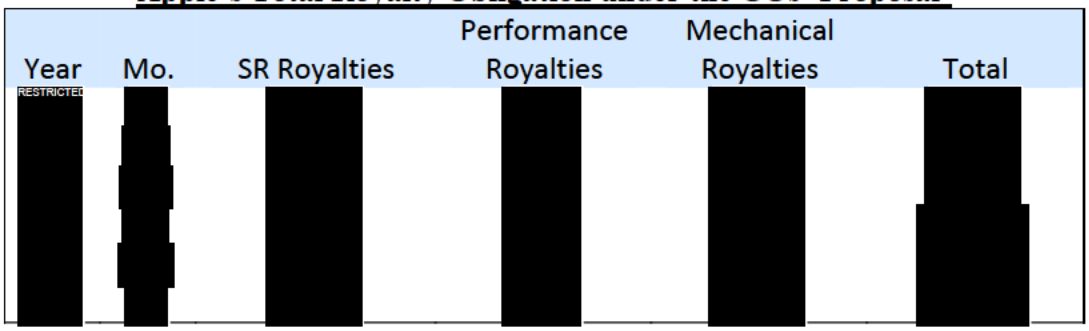
[5] Segal WDT ¶ 55.

21. The per-subscriber prong is particularly troubling given that it applies to subscription services only. Under the COs' proposal, ad-funded services do not have to pay this exorbitant per-subscriber rate and at least have more margin certainty as a result.

B. Unless Labels Agree RESTRICTED

22. Given the tremendous increase in mechanical royalties that the COs propose, if the Judges adopt the COs' proposal, the total royalties payable by Apple for music (both musical works and sound recording royalties in aggregate) for its interactive streaming service will be greater than RESTRICTED This is an untenable position.

Apple's Total Royalty Obligation under the COs' Proposal[6]



23. It should come as no surprise that it is not sustainable to offer a service if the cost of goods is RESTRICTED In a healthy business, goods typically cost around 65% of revenue or less, with the goal of creating returns of at least 5-10%. Even without the COs' proposed rate increase, RESTRICTED in royalties, RESTRIC improving margins is

[6] To the extent either performance or sound recording royalties differ from those reported in my prior statement, it is because Apple recently reconciled its data to use actual, rather than estimated, numbers per quarter.

difficult. But the COs' rate proposal makes the prospect of a healthy interactive streaming service impossible to imagine. Moreover, given that these costs are relative to the retail price, even a price increase cannot improve Apple Music's position. Using just the revenue prong, Apple's total cost of music would be about RESTRICTED of revenue using the first six months of 2021 as a reference point (RESTRICTED + 20% mechanical). No matter how much prices increase, services will always have to pay this percentage. This is in sharp contrast to other types of digital content services. For example, Netflix has COGS of less than 60%, with a good portion of its costs being fixed rather than revenue-based. This allows it to improve its margins through cost-saving efforts and price increases.

24. RESTRICTED

[redacted] While not part of Apple's original proposal, this suggests an all-in minimum RESTRICTED may be appropriate to at least control for this concern.

25. As discussed in my direct testimony, there also is no reason to think labels [redacted]. *See also* **APL-151.** As an initial matter, [redacted]. Further, as explained in my direct testimony, [redacted] in 2017. At that time, publishing royalty rates were fixed, [redacted]. **APL-073** at 1; **APL-74** at 1; **APL-075** at 1. At the time, the *Phonorecords III* decision was under appeal, so it was not known whether publishing rates would increase or not. [redacted] The pending *Phonorecords III* appeal did not factor into the change, nor did concerns that the *Phonorecords III* decision would increase publishing costs if it were upheld. In the end, given the various concessions to which Apple had to agree, [redacted]. *See* **APL-254** (*Phonorecords II* calculations listing TCC by month).

26. In other words, [redacted]

27. Perhaps in hopes of downplaying label market power, I understand that the COs suggest that labels are not actually "must haves" for services. They claim they are only "must haves" because other services also have catalogs from all labels. I disagree with this.

28. Apple could not offer an individual plan for $9.99 per month if it were missing one of the major label's catalogs. Most consumers would not pay that price for a service that is missing such a huge portion of the world's most popular songs. In fact, RESTRICTED [redacted] The only option would be to offer a much less expensive service, which would have to come with reduced royalty costs for the endeavor to make sense.

C. The COs' Proposal for Yearly Increases to the Per-Subscriber Minima and Per Play Minima Makes the COs' Proposal Even More Problematic

29. While the royalty increase I just described significantly threatens Apple's interactive streaming business in and of itself, the increases do not end there. Instead, the COs also propose annual increases to the per-subscriber and per-play minima. This is unreasonable and unsustainable.

30. *First*, as just described, under the COs' proposal, RESTRICTED [redacted].

31. *Second*, Apple's experience suggests that RESTRICTED [redacted]

[redacted] For example, as I explained in my opening statement, [redacted]

32. *Third*, Apple cannot constantly increase prices to offset increases in mechanical works royalties. Not only are many consumers unwilling to pay higher prices, but constantly increasing prices can [redacted]

33. *Finally*, to the extent there are increases in prices or service revenue, COs participate in that growth through the percentage of revenue prong. Further adjustments to minima are not necessary to keep pace with growth.

34. The bottom line is that the COs propose extraordinary increases in mechanical royalties that will make it nearly [redacted] or develop a healthy, sustainable music ecosystem.

III. THE COS' PROPOSAL TO ELIMINATE ROYALTY-FREE TRIAL PERIODS AND REQUIRE FULL ROYALTIES FOR STUDENT PLANS, EACH FAMILY PLAN USER, AND ALL OFFERINGS REGARDLESS OF FUNCTIONALITY IS HARMFUL TO COS AND THE INTERACTIVE MUSIC STREAMING INDUSTRY

35. In addition to pure rate increases, the COs' proposal contains another key flaw that will only harm the interactive streaming industry: it includes *no adjustments* to royalties for trial periods, family plans, student plans, limited functionality offerings,[7] or bundles. As described in my direct testimony, these offerings are essential to growing the interactive streaming market and attracting low-willingness to pay consumers. Segal WDT ¶¶ 17-31.

[7] Non-subscription services and Limited Offerings are not required to pay per-subscriber minima, but otherwise pay the same royalties as all other services.

Without adjustments for these types of offerings, services will not be able to engage in the market segmentation necessary to attract a wide variety of consumers to the paid interactive streaming marketplace. By proposing a percentage of revenue prong, the COs seek to benefit from growth in the industry that the services create, but they refuse to participate in making that growth possible. Meanwhile, the purpose of the percentage of revenue structure should be to create incentives on both sides to grow the services.

A. Requiring Full Per-Subscriber and Per-Play Payments for Student Subscribers and Each Family Plan User Is Harmful to the Interactive Streaming Industry

36. As described in my direct testimony, family and student plans are well-established tools for growing interactive music streaming subscribership and royalties because they encourage people to pay for music who otherwise might not do so. Segal WDT ¶¶ 21–22. Family plans also help encourage families not to share a single individual plan. *Id*. And both family and student plans entrench the idea of paying for music in younger consumers. *Id*.

37. Apple's RESTRICTED [redacted] A true and correct copy of an Apple analysis confirming these trends is attached hereto as **Exhibit APL-259.** These trends benefit COs immensely because paying subscribers generate higher royalties for COs than people using free services or not listening to music at all. Reducing churn and increasing conversion also help services to attract *and retain* consumers, which require significant resources. There seems to be an assumption that all services have to do is put a service into the market and people will join. That is not how it works. RESTRICTED [redacted]

[redacted], while at the same time benefiting COs through continuous royalties.

38. Given these benefits, it should come as no surprise that (as discussed more in Section VIII), [redacted].

39. Despite the benefits of family and student plans, [redacted], the COs' proposal includes no adjustments to minima for family and student plans. I do not understand how the COs can claim that a willing buyer and willing seller would agree to a rate without adjustments for family and student plans [redacted].

40. I understand that the COs try to justify their position by claiming that services use family and student plans primarily to increase market share vis-à-vis one another. If that were the case, you would expect services to continuously undercut one another's prices, but that is not what we do. Instead, family and student plans are well-established subscription tiers with widely-accepted restrictions around their eligibility (e.g., family members, student verification), which nearly every interactive streaming service offers. Including family and student plan discounts in the statutory rate gives the industry as a whole the tools it needs to attract and retain consumers across all services.

41. As proof of this, public sources report that the number of paying music subscribers has increased every year since 2014. **APL-255**. This shows that services are not

simply fighting for market share. Their tactics are increasing the total number of paid music consumers.

42. I also understand that the COs claim Apple and other services use family and student plans to drive future revenue at the expense of current revenue. This is a very distorted view of family and student plans. Apple's goal is to create a healthy, sustainable, and interactive streaming ecosystem of consumers paying for music. But the long-term health of the industry requires investing in the future by training consumers to pay for music. Student and family plans are an important part of this, as they help attract subscribers now and have the effect of increasing future revenue *and royalties* by entrenching the idea of paying for music with young people. In fact, Apple's student plans roll over into full paying plans, so the goal is for students to become full paying customers.

43. I understand that the COs also suggest that the risk of abuse of student and family plans cuts against including a discount for such plans in the regulations. I am not aware of any widespread abuse of these plans.

44. In the United States, student plans are available only to students studying a bachelor degree, post-graduate degree, or equivalent Higher Education course at a university, college. Students must verify their status as students *each year* to maintain the $4.99 student plan. Otherwise, the plan converts to a full-priced plan. Apple uses an independent service, UNiDAYS, to confirm student plan subscribers are, in fact, students. A true and correct copy of an excerpt from Apple's website regarding the requirements for joining an Apple Music Student Plan is attached as **Exhibit APL-247.**

45. With respect to Apple's family plans, guardrails against abuse are built into the plans' structure. Every Apple user has an Apple ID. The head of the family uses her Apple ID

to set up a Family Sharing Group. She can then invite other family members to use their Apple IDs to join the Family Sharing Group. People can join only one Family Sharing group at a time. Members of a Family Sharing Group automatically share certain features, like a shared photo album, a family calendar, and the ability to send reminders to one another—features a loosely connected group might not be interested in or might find annoying. In addition, if the head of the Family Sharing Group turns on the purchase sharing option, she must pay for all of the family members' purchases of Apple services, a further deterrent to having non-family members join a Family Sharing Group. In addition, Family Sharing Group members cannot automatically split payments for things like Apple Music among them, making it inconvenient for a group of loosely related people to use a Family Sharing Group to get a discount on the price of Apple Music, which would be a violation of the applicable terms and conditions in any event. True and correct copies of excerpts from Apple's website regarding requirements for joining an Apple Music Family Plan are attached hereto as **Exhibits APL-247; APL-248**.

46. Apple has also investigated whether consumers abuse Apple Music's Family plan option by looking into the make-up of families by age. It found, at worst, a very small subset of family plan subscribers may be unrelated, but that this is not a widespread problem. **APL-258**. Abuse, therefore, is no justification for rejecting family plan discounts.

47. If the Judges adopt the COs' proposal, Apple will be severely disincentivized from continuing to offer student or family plans. In fact, offering family plans would be impossible at current prices. Apple currently allows 6 family members to share a plan for $14.99 per month. Under the COs' proposed per-user rate of $1.50, this plan could cost Apple $9 per month ($1.50 times 6 people), or 60% of revenue ($9/$14.99), in mechanical royalties alone.

RESTRICTED. Further, as discussed above, RESTRICTED

Similarly, under the COs' proposed per-user rate for student plans, Apple would owe at least 30% of revenue ($1.50/$4.99) in mechanical royalties alone, bringing its total cost of goods for the student plan RESTRICTED, and greater if the mechanical to performing rights royalty ratio were to remain at 50:50. With these negative margins, student plans would also be unsustainable.

B. Eliminating the Zero-Royalty Rate for Trial Periods Is Harmful to the Interactive Streaming Industry

48. As explained in my direct testimony at paragraph 27, free trial periods (both for new subscribers and long-lapsed subscribers) are an essential, and widely accepted, method for converting people to paid music streaming. COs agreed to 30-day free trial periods in *Phonorecords II* and RESTRICTED

49. Nonetheless, the COs propose eliminating the royalty-free period. Their view seems to be that COs should not have to share in the discounts that services provide to consumers. This is a very short-sighted view. Trial periods benefit *both* interactive streaming services and COs because they help draw consumers away from free music services and/or piracy to paid music services that pay higher royalties. Consumers may not appreciate the benefits services offer—such as offline listening, music libraries, and curated playlists—until they try the service. Free trials allow consumers to get this hands-on experience. Because trials benefit both COs and services, *both* COs and services should participate in offering these trial periods. COs, however, seem to want all of the benefits that flow from the trials, without sharing in any of the costs. It is reasonable for the services to ask the COs to forgo a limited portion of

royalties when the services are making significant investments in marketing and customer acquisition.

50. There also is little risk of consumers abusing trial plans. Apple offers free trials to new and long-gone consumers only. The plan automatically switches to a full-priced plan at the end of the trial. In addition, free trials of Apple Music cannot be combined with free trials of Apple One. True and correct copies of excerpts from Apple's website regarding its trial plans are attached hereto as **Exhibits APL-226; APL-228.**

51. If the statutory rate does not include a royalty-free trial period, the continued offer of free trials by services will be in jeopardy. Discontinuation of such free trials would hurt COs because consumers are less likely to join a subscription service if they cannot test it first, and would also jeopardize the chances of long-term survival of interactive streaming services. As described, trial periods are an important promotional tool.

C. Requiring Full Per-Subscriber and Per-Play Payments for Offerings with Limited Functionality Is Harmful to the Interactive Streaming Industry

52. As explained in my direct testimony at paragraph 28, in addition to family and student plans, services offer subscription plans with limited functionality and lower prices to attract consumers who are unwilling or unable to pay $9.99 for a premium music streaming service.

53. In December 2021, Apple launched one such plan: the Apple Music Voice Plan, a $4.99 purely voice-activated plan. The Apple Music Voice Plan provides consumers with ad-free access to the full Apple Music catalog and curated expert playlists. Voice Plan subscribers, however, cannot download music for off-line listening, create playlists, create a music library of saved songs, view music lyrics, listen to higher-quality audio, or see what friends are listening to. They also are limited to playing songs via an oral request (or by using Type to Siri, Apple's

accessibility feature, or some limited tap capabilities in play history). Apple Voice subscribers receive ongoing prompts to upgrade to Apple's Individual subscription plan, particularly when they seek to do things that are not available in Voice, such as adding a song to a user's library. True and correct copies of excerpts from Apple's website regarding its Voice plan are attached as **Exhibits APL-231 and APL-228.**

54. The goal of the Apple Music Voice Plan is to attract customers interested in a lean-back music experience who are unwilling to pay for a premium music subscription. Apple also expects this plan to reduce churn and promote the premium Apple Music plan, all to the benefit of COs.

55. Other services offer similar limited functionality plans. Amazon, for example, offers a voice-activated interactive streaming service for $3.99 in connection with its Echo device.

56. Traditionally, certain limited functionality offerings have had lower per-subscriber minima than other plans. For example, under the *Phonorecords II* settlement and the remanded *Phonorecords III* decision, non-portable subscription services without off-line listening had a mechanical royalty floor of 15 cents per subscriber. Non-portable subscription offerings with off-line listening had a mechanical royalty floor of 30 cents per subscriber. Offerings with substantially limited catalogs had an all-in floor of 18 cents per subscriber. Just as lack of portability was a significant limit to functionality several years ago, today, a plan with only voice-activation is a significant limit. Further, services may develop other limited functionality plans in the future that help grow subscribership and increase the overall royalty pool. Accordingly, Apple proposes maintaining the lower minima for plans with limited functionality that have been in place since *Phonorecords II,* and adding an additional lower-

functionality tier to account for the new ways in which services attract consumers through limited functionality plans, such as voice plans. The proposal effectively takes what already existed and modernizes it.

57. The COs, on the other hand, propose eliminating all discounts for limited functionality plans. The only exception is that ad-supported services and services traditionally defined as "Limited Offerings" (e.g., substantially limited catalog plans) do not have to pay a per-subscriber royalty floor, but they still must pay a per-play floor.

58. This proposal will only hurt the interactive streaming industry, including the COs. Again, Apple's limited functionality plan is designed to RESTRICTED

Unsurprisingly, RESTRICTED **APL-046** at 8; **APL-076** at APL-PHONO4_00001704; **APL-077** at Ex.D1 (APL-PHONO4_00009679); **APL-243** at APL-PHONO4_00008663; **APL-261** at APL-PHONO4_00009708; **APL-249** at APL-PHONO4_00010056. Significantly, RESTRICTED **APL-243** RESTRICTED **APL-261** RESTRICTED **APL-249** RESTRICTED

59. If Apple has to pay the full per-subscriber or per-play minima RESTRICTED, creating the risk that both COs and consumers may miss out on the benefits the service was designed to provide.

D. Requiring Services to Pay the Same Royalty for Bundled Services as Standalone Services Is Harmful to the Interactive Streaming Industry

60. As explained in paragraphs 23 to 26 of my direct testimony, bundling an interactive streaming service with other services or hardware helps draw new users to interactive music streaming. For example, Apple launched its Apple One bundles, which combine Apple Music with other Apple services, in 2021. Approximately [redacted] of Apple One subscribers are new to music, meaning that they were not Apple Music subscribers before joining Apple One; [redacted] were lapsed Apple Music users and [redacted] had never subscribed to Apple Music. The data shows that Apple One [redacted]. Early evidence indicates that Apple One also [redacted]. A true and correct copy of an Apple analysis concerning Apple One is attached hereto as **Exhibit APL-234.**

61. The COs' proposal ignores these benefits from bundles. They propose that services pay the same royalties whether the music service is part of a bundle or not. With this structure, there is little incentive to include Apple Music in such a bundle because royalties are too high. The COs are cutting off their nose to spite their face. First, this means the COs will miss out on royalties from people who are unwilling to pay for a standalone music services. [redacted]. Second, [redacted].

62. The problems created by the COs' proposal will only get worse as bundles increase in popularity. Bundles are here to stay. If Apple cannot include music in bundles

because the Judges adopt the COs' proposal, then music may be left behind. Consumers with limited disposable income will be forced to choose between paying for bundles with non-music products and paying for Apple Music, with many choosing the bundled package, as it presents greater value per dollar.

E. Adjustments to the Per-Subscriber Floor in the *Phonorecords III* Decision Did Not Lead to Lower Mechanical Royalties for Apple as Compared to *Phonorecords II*

63. I understand that one reason that the COs want to eliminate the discounts I just described is because songwriters were concerned that their royalties did not increase under the vacated *Phonorecords III* rates, which adopted adjustments to minima for family and student plans. RESTRICTED .

64. As shown below, RESTRICTED . Therefore, the discounts in the *Phonorecords III* RESTRICTED as compared to *Phonorecords II*.

		Phonorecords II rates[8]	*Phonorecords III* rates[9]
2018		RESTRICTED	
2019		RESTRICTED	
2020		RESTRICTED	
2021	(10 months)	RESTRICTED	

65. To the extent the increase was not as dramatic as some people expected at first, it is only because the 10.5% headline rate under *Phonorecords II* was a mirage, as the effective rate

[8] Summarized from **APL-254** (*Phonorecords II* Calculation)

[9] Summarized from **APL-254** (*Phonorecords III* Calculation)

was significantly higher. Segal WDT ¶ 62. As shown in Section II above, if the Judges adopt the COs' proposal, the percentage of revenue headline rate will be similarly illusory.

IV. APPLE'S GOAL FOR APPLE MUSIC IS TO CREATE A HEALTHY, SUSTAINABLE ECOSYSTEM OF CONSUMERS PAYING FOR MUSIC

A. Apple Does Not Use Its Music Service to Promote Growth in Other Products and Services

66. The COs justify their proposed rate increase by pointing to Apple's revenue from non-music services. They speculate that Apple uses music to promote non-music products, so this non-music revenue should factor into determining royalties. To be clear, Apple does not view music as a way to promote non-music products. Rather, Apple Music is run as a separate line of business with a mandate to be sustainable and profitable in and of itself.

67. Apple also does not track music subscribers in terms of their "customer lifetime value" to Apple's entire ecosystem, as the COs' expert erroneously claims without supporting evidence. (Eisenach ¶ 60.) Rather, Apple cares about engagement with Apple Music specifically, and the health of that particular service.

68. Apple also does not use consumer data from Apple Music to cross-sell Apple products or Apple services that do not contain Apple Music. The COs do not cite any evidence to support their claim that it does.

69. In fact, to the extent a relationship exists between Apple Music and Apple's hardware, it is the other way around: Apple's hardware products help promote Apple Music (and other products containing music) and improve paid music consumption.

70. For example, last year, Apple launched a promotion under which owners of certain AirPods wireless headphones, Beats headphones, and HomePod speakers could receive six months of Apple Music for free, as long as they were new Apple Music subscribers. Importantly, the promotion applied to current owners of these products, so even people who

bought these products before Apple began the promotion could take advantage. This shows that Apple was tapping into the consumer base for certain hardware products to promote Apple Music, not the other way around. A true and correct copy of Apple's website explaining this promotion is attached as **Exhibit APL-227**.

71. Apple also makes Apple Music available on non-Apple platforms, another sign that Apple does not use Apple Music to promote Apple hardware or lock people into its ecosystem. For example, Apple Music is available on Android devices, Amazon's Alexa operating system, Samsung TVs, PlayStation 5 consoles, and many other non-Apple devices. A true and correct copy of the Apple Music listing on the Google Play store is attached as **Exhibit APL-222**. A true and correct copy of a printout from Apple's website explaining how to use Alexa to play music from Apple Music is attached as **Exhibit APL-232**.

72. Similarly, Spotify, Amazon Unlimited, and several other music services are compatible with Apple devices and sold through Apple's App Store. True and correct copies of listings for Spotify, Amazon Unlimited, and Deezer on the App Store are attached hereto as **Exhibit APL-256**; **APL-219; APL-220**. Apple even advertises its HomePod mini device by noting that it lets consumers "stream content from third-party services," including Pandora's noninteractive music service. A true and correct copy of Apple's webpage for the HomePod mini is attached hereto as **Exhibit APL-257.**

73. This compatibility between the services' various devices and their music services not only undercuts the COs' argument that Apple uses Apple Music to bolster sales of other Apple products, it also highlights the many ways in which Apple's devices and hardware benefit the COs outside of Apple Music. As discussed more below in Section VI, Apple invests heavily in marketing, research and development, and high-quality listening devices, all of which

facilitate and/or encourage the consumption of music and other forms of entertainment that incorporate music (e.g., television). As a result, Apple bolsters COs' revenues directly through Apple Music and indirectly by making other music platforms and forms of entertainment containing music easier and more enjoyable to consume.

74. Finally, Apple was an enormously successful company well before it began offering interactive streaming, which success would not be impacted if it were to discontinue offering Apple Music. Interactive streaming did not cause Apple to become a success in other business areas.

B. Revenue from Products Other than Interactive Streaming Should Not Factor Into Setting the Mechanical Royalty Rate

75. In any case, regardless of Apple's (or any company's) business model, digital service providers' non-music revenue should not factor into setting the royalty rate for interactive music streaming. *First*, to the best of my knowledge, the COs' have not supported their assumption about complementary revenue with any actual proof, quantified the supposed complementary revenue that services receive, or established how complementary revenue fits within the WBWS standard. Without these three things, there is no basis for adopting a rate that bakes in the COs' speculations about complementary revenue.

76. *Second*, music service providers have long been diversified. Apple, for example, began offering music downloads through the iTunes Music Store in 2003. At that time, Apple was already a well-established computer hardware and software company, selling, among other things, the iPod digital music player. Yet sound recording and musical works owners have never received a portion of Apple's revenue from other products or increased rates to capture supposed complementary revenue, as they were never able to make a business case for doing so. That reality has not changed today.

77. In fact, I understand that in November 2008, the CRB set the mechanical royalty rate for digital downloads for the first time. Apple was still one of the most prominent sellers of digital downloads in 2008 and continued to sell the iPod digital music player. Amazon was also in the download market at the time. Yet the CRB adopted the same mechanical royalty rate for digital downloads, sold through diversified companies like Apple and Amazon, as for CDs and other physical sales, and did not include digital music player revenues in such rate. A true and correct copy of a New York Times article regarding the proceeding is attached hereto as **Exhibit APL-208.** Further, the 2008 rate was the same rate as the Librarian of Congress adopted for physical sales in 1997, long before Apple entered the digital download market.[10] The presence ten years later of diversified companies as music distributors did not change the mechanical royalty rate.

78. COs have not received a portion of revenue for companies' lines of business unrelated to music, or increased royalty payments to account for revenue unrelated to the music service, in the streaming context either. For example, in RESTRICTED [redacted] was not intended to, nor did it, reflect the value of Apple's non-music business lines.

[10] The rate was set to begin in 2006, but was established in 1998.

79. Apple's [redacted] RESTRICTED [redacted]

80. *Third*, there are many reasons people buy Apple products other than music. It is pure speculation to assume that music drives Apple's sales. For example, while I understand that the COs' expert, Dr. Flynn, states that people "listen to music on their Apple Watches" (Flynn ¶ 75), they also can do many other things on their Apple Watches, such as ascertain the time, answer calls, send messages, look up directions, check stocks, make payments using Apple Pay, board a plane, track and send their heartrates and ECGs, measure calories burned, and set alarms. In fact, the press release for Apple Watch, a true and correct copy of which is attached hereto as **Exhibit APL-209,** does not even mention whether consumers can use Apple Watch to listen to music.[11] iPhone devices also have myriad uses beyond listening to music and were popular long before Apple launched Apple Music. The mere fact that consumers can listen to music on their Apple Watch or iPhone devices does not mean music drives Apple Watch and iPhone sales.

81. Consumers can also use AirPods and HomePod devices to do many things other than listen to music. Consumers can use AirPods to make phone calls, enjoy television shows, watch movies, play games, interact with Siri, and participate in FaceTime calls. Apple touts all of these benefits in promotional materials for AirPods. True and correct copies of press releases for AirPods are attached hereto as **Exhibits APL-215; APL-211.** HomePod mini devices similarly allow consumers to listen to Apple TV, take telephone calls, listen to podcasts, and

[11] I understand that Ms. Flynn speculates as to Apple's U.S. revenue from products such as Apple's HomePod and the Apple Watch. Apple does not concede the accuracy of Ms. Flynn's statements, but sees no need to delve into the numbers because Apple's revenue from products other than its interactive streaming service is not relevant.

listen to non-interactive services and radio, all of which Apple promotes in press materials for the product. A true and correct copy of a press release for the HomePod mini is attached hereto as **Exhibit APL-213.**

82. *Fourth*, the COs' argument that they should receive higher royalties and/or use revenue from non-music business lines to calculate the appropriate royalty rate because music supposedly drives hardware sales ignores the ways in which the services' hardware products actually help drive CO revenue. Apple invests heavily in marketing and research and development to provide high-quality listening experiences in every facet of a customer's life—in-home, in-ear, mobile, and others. Marketing encourages people to listen to music. Apple's hardware and devices make it easier and more enjoyable for them to do so, whether through interactive streaming, internet radio, non-interactive streaming, or another type of music service. Apple's hardware and devices also make it easier for consumers to use other types of services *not* offered by Apple that incorporate music and generate revenue for the COs, such as social media apps (e.g., TikTok), fitness platforms (e.g., Equinox app), video services (e.g., YouTube), and television (e.g., Netflix). If the Judges were to raise mechanical royalty rates to account for the purported extra revenue that services supposedly earn from their non-music business lines as a result of offering music (for which the COs have offered no evidence), it would only make sense to also *reduce* royalties to account for the extra income that the services' devices and platforms help the COs generate. Tellingly, the COs do not propose a discount to royalties to account for the ways devices have facilitated the growth of music royalties through these other revenue streams.

83. *Finally*, using revenue from non-music business lines to set the mechanical royalty rate will likely make it impossible for non-diversified services to enter the interactive

streaming market. The royalty rate should not factor in non-music business lines as it would create an unlevel playing field and raise competition concerns.

84. Moreover, all of these reasons make it not credible that setting the mechanical royalty rate in this manner could meet the willing-buyer willing-seller standard.

C. The COs' Speculation That Complementary Revenue Factors into Apple's Rate Negotiations Is Misguided

85. Although Apple does not use music to drive non-music revenue, I understand that the COs speculate that there are information asymmetries in Apple's negotiations with COs and labels because Apple allegedly has information about how its music services impact other lines of business that the COs and labels do not have. I know of no support for this.

86. Put simply, Apple does not factor other lines of business into its Apple Music negotiations. Nor does it have any information indicating that music promotes other business lines. Again, Apple wants Apple Music to be a healthy, profitable standalone business.

87. I also understand that the COs speculate that RESTRICTED [redacted] .[12]

88. Given that Apple has been a diversified company since Apple Music launched, it is ridiculous to suggest that RESTRICTED somehow relates to complementary revenue. Instead, RESTRICTED [redacted]

[12] Specifically, RESTRICTED [redacted] . **Exs. APL-046** (Warner); **APL-245** at Section 4(b) (UMG) ; **APL-076** (SME).

RESTRICTED

. **Exs. APL-046** (Warner); **APL-245** at Section 4(b) (UMG) ; **APL-076** (SME)**.**

D. Apple Does Not Underprice Apple Music

89. In addition to speculating that music drives revenue for non-music services, I understand that the COs also make the odd argument that Apple underprices its Apple Music services (to supposedly improve market share and generate complementary revenue) as justification for the COs' proposed rate increase. This is not correct.

90. Apple is a for-profit, public company trying to create and maintain a sustainable interactive streaming service. In setting prices, it looks at competition as well as potential margins for the Apple Music service. But it cannot set whatever price it wants. It has to consider competition and consumers' willingness to pay for interactive streaming. It also has to consider how to initially attract consumers to a new paid service.

91. There are still many ways to listen to music without paying a fee, including ad-supported services and piracy, and, simply put, it is hard to compete with free. Interactive music streaming services also compete with many other music and non-music services that consumers can enjoy throughout the day, e.g., music radio, talk radio, non-interactive streaming, television, gaming, live-streaming (such as Twitch), social media, podcasts, movies, audiobooks, etc. Pricing must take into account that if prices are too high, consumers can switch to one of these other forms of entertainment, all of which compete for consumers' limited time.

92. Contrary to the COs' claim, Apple's decision not to raise prices when it first offered Lossless Audio does not establish that Apple is not trying to make Apple Music a profitable business. RESTRICTED , as clearly shown by the very small portion of consumers who subscribed to pre-existing lossless music tiers

offered by third parties. Tidal was traditionally known as the streaming service for consumers who wanted very high quality audio, yet it has had much smaller subscribership than Spotify, Apple Music, and many other services. Therefore, RESTRICTED .

93. On the other hand, RESTRICTED . It also is not clear why COs care about RESTRICTED . Therefore, RESTRICTED . Yet they will, via the percentage of revenue prong everyone in this proceeding proposes. RESTRICTED are pure incremental revenue for COs—increased royalties for no additional work.

94. The COs' claim (e.g., Flynn ¶ 23) that services are not trying to maximize profits because they do not compete for exclusive content is also inconsistent with business realities. The whole argument is a bit ridiculous, as it was ***the music industry*** that pushed back on services providing exclusives.

95. When Apple Music first launched, Apple tried to offer exclusive access to certain new music. Labels, however, were concerned that exclusives led to an increase in piracy. Therefore, they no longer wanted their artists to have exclusive deals. The industry continues to

run into this problem today. For example, consumers quickly found ways to pirate Kanye West's latest tracks after he tried to upload them exclusively to Stem Player. True and correct copies of articles discussing this issue are attached hereto as **Exhibits APL-213; APL-210; APL-216.**

96. It also is not accurate to say Apple does not offer exclusive content. Apple creates a lot of original content around artists and projects, at its own cost, which provides marketing to publishers and songwriters, at no cost to them. But exclusives, especially high-profile exclusives like the COs seem to be referencing [redacted] even if the industry were to support them. Again, consider Tidal, which offers backing from major artists, and exclusive albums, yet has never reached the same level of subscribership as many other services.

97. It also is not appropriate to compare interactive music streaming to other types of content providers, such as television, because the ways consumers interact with their catalogs are completely different. Customers choose a video streaming service that has particular content they want to watch, typically just once, whereas customers want to be able to hear all of the most popular songs of the day, listen to them multiple times, and save them in libraries and playlists for future listening. Labels are also disincentivized to permit their artists to create exclusive content for a particular music streaming service, because it limits the content's popularity, chart position, and reach. Other services won't be able to promote that content through things like editorial featuring or playlists.

98. Given the music industry pushback on certain exclusives and the high cost of high-profile exclusives, Apple has focused on other things (e.g., playlists, browse features, and other features discussed in my opening statement at ¶ 18) to distinguish itself from other streaming services and attract consumers.

99. The COs' pricing argument also misses the ways in which royalties impact pricing decisions. The COs would like Apple Music to raise the price of a subscription, which is hardly surprising given that due to percent of revenue prongs, in aggregate with the labels, they receive more than RESTRICTED of every dollar that the price increases, more if the Judges adopt the COs' proposal. For Apple, however, raising prices brings some risk: as prices rise, the cost to acquire new customers and to retain existing customers necessarily rises as well, RESTRICTED of revenue, which is essentially a fixed share under the percentage of revenue royalty structure; if Apple adds other content to the subscription, such as music videos and lyrics, to increase the value of the subscription to consumers, the cost of this content and the engineering to integrate and manage this content comes at an additional cost, RESTRICTED; if Apple develops new features for the subscription such as Spatial Audio this too comes at additional cost that Apple pays from its RESTRIC. Apple needs an RESTRICTED To be clear, Apple does not propose removing the percentage of revenue from the royalty formula in this proceeding, in recognition of the importance COs have attributed to this prong despite some of the inefficiencies it may cause. Apple, however, suggests that the percentage should certainly not increase as the COs propose.

V. THE COS' PROPOSAL IGNORES THE ECONOMIC REALITIES OF THE INTERACTIVE STREAMING MARKET

100. The COs also present a highly misleading picture of the music industry to support their proposal. At bottom, they suggest that mechanical royalties from interactive streaming alone should sustain songwriters and the publishing industry. This places an inappropriate burden on interactive streaming services and ignores the many other ways in which COs generate revenue.

101. Perhaps the most glaring omission in the COs' submission is the lack of consideration of performance royalties. Interactive streaming provided songwriters and publishers with a whole new revenue stream in the form of performance royalties. Whereas downloads and physical sales generate only mechanical income, interactive streaming services pay mechanical *and* performance royalties. Third party analyses show that performance royalties have more than offset any decrease in mechanical royalties earned from downloads, CDs, and vinyl, meaning current rate levels more than adequately compensate COs when viewed holistically. **APL-151**. This performance income cannot be ignored when assessing the financial impact of interactive streaming on publishers and songwriters.

102. Interactive music streaming also is not the only type of streaming service. The growth of the internet has opened many new revenue streams for COs, including music-focused services, such as non-interactive services and internet radio, and services that incorporate music, such as social media. By promoting music listening, interactive music streaming services help grow all types of on-line music platforms. There is no reason that mechanical royalties from interactive streaming should alone sustain the publishing and songwriting industry when all of these other revenue streams also generate income.

103. Further, to the extent individual songwriters raise concerns about the size of their royalties, this is largely due to an increase in the number of songwriters sharing the pie for any given song, which the *publishers themselves* encourage by facilitating more collaborations. Technological advances and disintermediation also lower barriers to entering the songwriting profession. This does not mean services should have to pay higher royalties.

104. The COs also lament the loss of the payment model where songwriters earned mechanical royalties regardless of whether their songs were played just because they were included on an album. By contrast, interactive streaming compensates songwriters in direct proportion to the number of times their songs are played. This is a far more economically efficient model, aligned with a competitive marketplace and the constitutional underpinnings of copyright law to promote the creation of works for public benefit. The Judges should not strive to align rates here with a model that does not accurately compensate creators for music, but rather should support a model that more effectively reflects the public's listening habits.

105. Finally, the publishers make several statements about the purported need to pay large advances to songwriters to maintain a healthy supply of new songs. While this is how business has been done, I am not aware of any requirement that publishers pay large advances to ensure the supply of new music. Instead, the proliferation of new, independently-created music on interactive streaming and other platforms, which lowered barriers to entry, suggests that high advances may not be necessary and are instead part of publishers' strategic choices. The COs expect services to fund this business strategy through higher rates, while at the same time advocating against discounts that support the services' business strategies. To the extent advances have increased, this is a function of publishers having more to spend as they compete for songwriters and catalogs due to strong revenue growth from interactive streaming.

VI. STATUTORY ROYALTIES DO NOT ACT AS A RATE CEILING

106. The COs also attempt to justify their rate proposal by claiming that statutory rates act as a ceiling, so should be set toward the high end of what is reasonable and not take into account discounts because those can be negotiated in the market. This does not make sense to me.

107. *First*, the RESTRICTED The COs may claim that those rates were not actually higher RESTRICTED .

Comparison of Apple's Mechanical Royalties under Direct Deals vs *Phonorecords II*

	Phono II rates[13]	Direct Deals
2017	RESTRICTED	
2018	RESTRICTED	
2019	RESTRICTED	
2020	RESTRICTED	

It's not realistic to assume that direct negotiations between services and COs would result in rates lower than the statutory rates, when COs have no incentive to agree to lower rates and when the statutory rates themselves are already based on a WBWS standard.

108. *Second*, setting a rate with the idea that services and COs will negotiate something lower if the rate is too high undercuts the essential purpose of passing (at great effort by the industry) the Music Modernization Act ("MMA") and establishing the MLC. The MMA helped

[13] Summarized from **APL-254**.

streamline the licensing process by enabling services to acquire mechanical rights through a single license rather than millions of NOIs and setting up the MLC to administer that license. However, services now pay millions of dollars per year to fund the MLC, and it is not fair and in some cases not economically feasible for them to pay twice for administration of their licenses—once under the compulsory MMA assessment, and again to administer direct licenses.

109. If services need to negotiate separate licenses in addition to the blanket license because the Judges set the rates too high, it would undermine the essential purpose of the MMA to streamline licensing through a blanket license, and requires double payment by the services of substantial operating costs.

VII. THE COS' PROPOSAL INCLUDES SEVERAL OTHER DEFINITIONAL AND STRUCTURAL CHANGES THAT ARE NOT PRACTICAL

110. In addition to the extremely high rates and the lack of adjustments to minima, the COs' proposal contains several other terms that depart considerably from the terms to which the services and COs agreed previously, and that the Judges adopted previously. These new terms are impractical, inconsistent, and bad for the interactive streaming industry. By contrast, Apple's proposed terms hew more closely to those agreed upon in *Phonorecords II*, adopted by the Judges in *Phonorecords III*, or are RESTRICTED [redacted]. Accordingly, rather than adopt the COs' near wholesale rewriting of several terms, the Board should adopt the terms in Apple's proposal.

111. Here I call out some of the problematic terms but, again, overall, I encourage the Judges to adopt Apple's proposed definitions in their entirety.

A. Services Should Not Be Subject to Four Different Payment Prongs

112. Apple proposes a simple, straightforward rate structure with two prongs: a percentage of revenue and a per-subscriber minimum.

113. By contrast, the COs' proposal includes four different payment prongs, any of which could bind in any given month: percentage of revenue, TCC, per-subscriber mechanical floor, per-play mechanical floor.

114. Having four different payment prongs is not practical from a business perspective, as the more prongs there are, the greater the cost unpredictability. As for any business, when costs are unpredictable, it is very difficult for services to plan ahead.

115. Having four different rate prongs is also inconsistent with RESTRICTED [redacted].

116. In addition, as discussed in my WDT, the uncapped TCC prong improperly links musical works royalties to sound recording royalties in violation of the WBWS standard. In addition, RESTRICTED [redacted]. Therefore, RESTRICTED [redacted] COs want 20% of revenue or 40% of RESTRI [redacted]. There is no reason for such duplication, particularly when other backstops to the revenue prong exist.

B. The COs' Definitions of "Revenue" and "Service Provider Revenue" Are Vague and Lack Sensible Deductions

117. Apple proposes a reasonable, clear definition of revenue with common, sensible deductions, such as taxes, carriage or in-app commission fees (capped at 30%), and other distribution partner fees (capped at 10%).

118. By contrast, the COs' definition of revenue suffers from numerous flaws which will only create confusion and uncertainty as to how to calculate royalties. I highlight several problems below. *First*, the definition does not explicitly allow deductions for taxes, carriage

fees, in-app fees, or other distribution partner fees. Services, however, only collect these fees on behalf of third parties, such as the government, so they should not be included in a service's revenues.

119. *Second*, the proposal does not include a reference to GAAP, and, therefore, is vague as to how services should treat monies received by them.

120. *Third*, several terms in the definitions of "Service Provider Revenue" and "Revenue" are ambiguous. For example, I am not sure what the catch-all phrase "any other Revenue in connection with any Licensed Activity" in the definition of Service Provider Revenue references. The definition also refers to revenue "in connection with Licensed Activity," rather than "recognized by" the service provider, as in the prior rates and terms, which also adds confusion and appears to be a further step to broaden the scope of what counts as revenue. The references to monies "actually received by, or receivable by, and all payments made to, or credited to" in the definition of Revenue is also unclear and seems to imply that services should pay royalties on revenue they have not received or do not keep, which does not make sense and will be challenging to implement.

C. The Definitions of "End User" and "Subscriber" Are Unclear and Bad for the Interactive Streaming Industry

121. As explained above, the requirement in the COs' definition of "Subscriber" that "each sub-account of a multiple user plan counts as a distinct Subscriber (i.e. if a Family Plan allows for six End Users, it will consist of one primary account Subscriber and five additional sub-account Subscribers)" is prohibitively expensive, harmful to industry growth, and would negatively impact overall retention and, consequently, COs' royalties. Services are not paid for each sub-account in a family plan, so this definition does not reflect how these plans work in the marketplace. It is very unlikely that services will be able to offer family plans under such terms.

122. The definition of "Subscriber" is also confusing because it incorporates the term "End User," but an "End User" is defined as a "Subscriber." Specifically, under the COs' proposal, "*Subscriber* means an End User with an account or sub-account . . ." "*End User* means each individual person that: (1) is a Subscriber . . . ." The definitions are circular.

D. The COs' Proposal Inappropriately Requires Paid Locker Services to Pay the Same Royalties as Interactive Streaming Services

123. Paid locker services allow consumers to download or stream music they have legally acquired outside of a streaming service in exchange for a fee. Paid locker subscribers cannot listen to any music other than that already in their possession and for much of which COs will already have been paid. Because COs were already compensated for music in a paid locker service that the service is able to identify at the time of purchase, paid locker services have traditionally had lower rates than interactive streaming services.

124. The COs propose eliminating paid locker services. Instead, their proposal includes only one type of locker, a "Purchased Content Locker Service." This refers to any "Offering providing digital access to sound recordings of musical works in the form of Eligible Interactive Streams, Permanent Downloads, or Restricted Downloads *at no incremental charge above the otherwise applicable purchase price of the digital downloads, or physical phonorecords*, for which the Service has reasonably determined that the End User has purchased from a qualifying seller phonorecords of the applicable sound recordings prior to the End User's first request to have access to the sound recordings by means of the Service. . . . ." COs' Proposal § 385.2 at A-4 (emphasis added). Because the definition refers only to services offered "at no incremental charge," it does not include Paid Locker Services.

125. The COs argue that Paid Locker Services no longer exist, so the category should be eliminated. But Apple still offers a paid locker service called iTunes Match for $25 per year,

and other similar services could emerge. It does not make sense for these services to have the same rate as interactive streaming services, when users can only stream songs they already possess, the vast majority for which COs already received compensation. It is questionable whether any royalty should be due for this type of service, but in the interests of continuity Apple proposes the Paid Locker Service category should be maintained on the terms Apple proposed.

E. If the Judges Keep a TCC Prong (They Should Not), They Should Not Use the COs' Proposed Definition

126. As I have explained, a TCC calculation is inappropriate, especially under a WBWS standard, because it ties mechanical royalties to the labels' market power and rights not licensed under the statute. In the event the Judges keep this prong, however, they should not use the COs' proposed definition. This definition eliminates the reference to GAAP as the method for determining the total amount expensed by service providers for the right to make sound recordings available and replaces it with a vague and confusing reference to "all applicable consideration conveyed, paid, or otherwise provided by the service provider." The original definition of TCC from *Phonorecords III*, including GAAP, should be retained as a metric for calculating TCC, as it is clearer than the COs' proposal and the parties understand how to apply it. The COs' proposal will only create confusion.

F. The COs' "Restricted Download" Category Is Vague and Confusing

127. The COs add a new category for Restricted Downloads, which they define as "a Digital Phonorecord Delivery that remains accessible for future listening, but may not be retained and played on a permanent basis. The term Restricted Download excludes Eligible Limited Downloads and Eligible Interactive Streams." They assign Restricted Downloads the same rate as permanent downloads. There are two problems with this proposal. *First*, it is not clear what uses fall into this category. *Second*, temporary downloads, that users may have to

download again in the future, should not have the same rate as permanent downloads. The COs seem to be creating an opportunity for multiple payments for a single download with this ambiguous, new category.

G. The COs' Definition of a "Bundled Subscription Offering" Is Overly Narrow

128. The COs make several changes to the definition of Bundled Subscription Offerings that appear to narrow the scope unnecessarily. *First*, the addition of the phrase "marketable products or services" is vague and confusing.

129. *Second*, the definition is ambiguous in how or whether it includes hardware bundles in which a company offers an existing standalone subscription service for free or at a discounted price to purchasers of hardware. Instead, the definition confusingly states that bundles include "a discounted Subscription Offering that is available only to consumers who have purchased one or more other products or services." It is unclear whether this includes situations where a service offers a music plan that ordinarily exists as a standalone service at a discount to hardware purchasers, as in Apple's AirPods offer. The reason for the ambiguity is that, in this example, the offering is not available "only" to hardware purchasers; instead, the discount is the piece available only to hardware purchasers. There is no reason to limit or exclude hardware bundles when those help promote subscribership, just like service bundles.

130. *Third*, the COs reintroduce "products" into this definition, but, as I have previously noted, it is challenging to allocate revenue to the music services in hardware bundles, as consumers typically pay one-time, lump sum fees for such bundles. Consequently, it makes sense to treat service bundles and hardware bundles separately, as Apple has, which is consistent with Apple's direct licenses.

H. The COs' Definition of Limited Offering Is Too Narrow

131. The COs' definition of Limited Offering is overly restrictive, particularly considering that it does not propose any other tiers for services with different types of limited functionality, such as the Apple Music Voice Plan. The COs want all services to fit into only two buckets—exceptionally narrow services that cater to a specific genre or have only 3,000,000 songs and premium plans. The marketplace is much more diversified, which serves consumers and COs well. As described previously, market segmentation and diversification are critical to continued growth in the interactive streaming marketplace. The COs' failure to account for such segmentation in their proposal is bad for the industry and should be rejected.

VIII. THERE IS NO SUPPORT FOR THE COS' PROPOSAL

132. Not only is the COs' rate proposal bad for the interactive streaming industry, COs included, Apple's RESTRICTED also do not support the COs' proposal.

A. RESTRICTED Do Not Support the COs' Proposal

133. As discussed in paragraphs 116 to 118 of my direct testimony, prior to launching Apple Music, RESTRICTED **APL-078**; **APL-079**; **APL-080**. These agreements were heavily negotiated over the course of several months to reach terms on which both parties could agree. Apple also RESTRICTED **APL-029–030**; **APL-082–APL-105**; **APL-156**. RESTRICTED

134. Unlike the COs' proposal, RESTRICTED [redacted]. **APL-029–030**; **APL-078–APL-080**; **APL-082–APL-105**; **APL-156**. RESTRICTED [redacted] the COs propose four different payment prongs. I am not aware of any precedent for such an approach.

135. RESTRICTED [redacted] A**PL-029–030; APL-078–APL-080; APL-082–APL-105; APL-156**. The COs, on the other hand, do not include any student or family plan adjustments in their proposal.

136. RESTRICTED [redacted]. **APL-029–030; APL-078–APL-080; APL-082–APL-105; APL-156**. As noted above, RESTRICTED [redacted]. The COs, by contrast, propose the services pay full price during trial periods.

137. RESTRICTED [redacted] adjustment to revenue that Apple

proposes. **APL-043; APL-023**. [redacted]. **APL-028; APL-019; APL-022; APL-023**. The COs propose no adjustments or discounts for any type of bundle.

138. [redacted]. **APL-029–030; APL-078; APL-079; APL-080; APL-082–APL-105; APL-156.** The COs do not propose any similar deductions.

139. [redacted] Now the COs propose a 20% of revenue rate, all-in, and $1.50 per subscriber *for mechanical royalties only*. They want [redacted].

B. Apple's PRO Agreements Do Not Support the COs' Proposal

140. As discussed in paragraph 128 of my direct testimony, [redacted] Apple first entered into these agreements [redacted]. After I submitted my direct testimony, Apple [redacted]. Specifically, Apple entered into [redacted]

[redacted] Like the Publisher Agreements, these agreements were also carefully negotiated over many months to come to terms to which both sides could agree. True and correct copies of the newest amendments to the ASCAP, BMI, SESAC, and GMR agreements for Apple Music are attached hereto as **Exhibits APL-243, APL-249, APL-261, and APL-250** respectively. I refer to the agreements with ASCAP, BMI, SESAC, and GMR for Apple Music collectively as the "PRO Agreements." The PRO Agreements do not support the COs' proposal.

141. [redacted] **APL-024** at Section 5.3.1(a); **APL-025** at Section 5.2.1(a); **APL-133** at 5.2.1(a). [redacted] **APL-026** at Section 4(a). [redacted] , the COs propose four different payment prongs.

142. [redacted] **APL-024** at Sections 5.3.1(c), 5.3.2(a); **APL-025** at Sections 5.2.1(c), 5.2.2(a); **APL-133** at Sections 5.2.3, 5.2.3; **APL-249** at Section 3(c)(2) [redacted]

[redacted]). The COs do not include any student or family plan adjustments in their proposal.

143. [redacted], and adjustments for winback periods. **APL-024** at Sections 5.3.3; **APL-025** at Sections 5.2.1(c), 5.2.2(a); **APL-133** at Sections 5.2.1(c), 5.2.2(a); **APL-249** at Section 5.2.3. The COs propose the services pay full price during trial periods.

144. All of [redacted]. **APL-047** at Section 4.3(e)); **APL-261** at Section 5(c)(vii) (SESAC); **APL-134** at Section 6 (BMI); **APL-260** at Section 4 (GMR). [redacted] **APL-243** at Section 6(b), **APL-249** at Section 3(a), **APL-261** at Section 6(c). The COs propose no adjustments or discounts for any type of bundle.

145. [redacted] **APL-243** ([redacted] **APL-249** [redacted]. On the other hand, the COs' proposal does not include any adjustments to the per-subscriber or per-play rates for limited functionality offerings.

146. Finally, although the PROs renewed their agreements with Apple for Apple Music [redacted]

RESTRICTED alone. For Apple Music individual plans, RESTRICTED

- **BMI**: RESTRICTED **APL-249** RESTRICTED
- **ASCAP:** RESTRICTED APL-047 at Section 1(b); **APL-243** at Exhibit A.
- **GMR:** RESTRICTED **APL-250** at Section 2(a); **APL-159** at Section 2.
- **SESAC:** RESTRICTED **APL-025** at Section 5.2.1; **APL-159**.

147. Collectively, RESTRICTED

148. This disparity between the amount the COs demand for the mechanical right and what they agreed to for the performance right makes no sense to me. The performance and mechanical rights are perfect complements when it comes to interactive streaming. I cannot think of any reason why they should be valued so differently. In fact, my understanding is that administrative costs related to the mechanical right should be lower than with respect to the performance right because services pay the MLC's administrative costs. Therefore, the mechanical royalties do not have to cover these third party administrative costs as those are paid separately. These PRO agreements strongly undercut the COs' claim that their proposal satisfies the WBWS standard.

C. Apple's Label Agreements Do Not Support the COs' Proposal

149. As discussed in paragraphs 133–140 of my direct testimony, RESTRICTED [redacted]

- RESTRICTED Rather, RESTRICTED [redacted]. **APL-067–APL-069** at Section 5.
- RESTRICTED [redacted] **APL-067–APL-069** at Section 5(f)–5(g); *Id.* at Exhibit C.
- RESTRICTED [redacted] **APL-054** at Section 2; **APL-055** at Sections 2–3; **APL-072** at Section 4.
- RESTRICTED [redacted] **APL-046** (Warner); **APL-074** at Section 2(c), **APL-245** at Section 4(b) (UMG) ; **APL-076** (SME).
- RESTRICTED [redacted]. **APL-046** (Warner); **APL-077** at Section 3(b) (UMG); **APL-076** (SME).

150. As for the rates themselves, I understand that the COs argue that the ratio of the royalties they earn compared to the royalties labels earn from interactive streaming should be 2.5:1. This approach is troublesome because the Judges cannot set label royalties and, as explained in my opening statement, RESTRICTED [redacted] It also fails to take into account increases in costs borne by labels for which their royalty rates are intended to compensate, which are not applicable with respect to the musical works. Because RESTRICTED [redacted], any increase in mechanical

royalties to achieve this 2.5:1 ratio comes out of services' margins. The narrower services' margins, the more difficult it is for them to cover their other costs relating to the operation of the services or earn even a slim profit, both of which services must do if the industry ever hopes to have a healthy, sustainable, music ecosystem. Setting rates based on this ratio essentially benefits the COs (who already profit tremendously at current rate levels) at the expense of the services RESTRICTED Services' profit margins should not be subject to what is really a debate between labels and publishers about how to split royalties between them.

151. History also shows that there is no fixed ratio. Rather, the value of sound recordings to the value of musical works varies widely depending on myriad factors, such as the type of use; the popularity of the recording; costs; and the availability of substitutes (for example, a company that wants to play background music may not care what group of songs it licenses whereas an interactive streaming service has to have the specific recording of a song that consumers want to hear). Take, for example, downloads, which are similar to interactive streaming in that the owner of the download can listen to the song anytime he or she wants and carry the song with her on a portable device. To distribute downloads, RESTRICTED

attached hereto as **Exhibits APL-251–253**. Labels were then responsible for passing on the 9.1 cents per download mechanical royalty to publishers. RESTRICTED

.

152. To the extent the Judges choose to look at a ratio anyway, RESTRICTED

[redacted] In addition, the COs' proposal does not actually achieve a 2.5:1 ratio. Rather, [redacted] This is likely because the labels [redacted] COs do not incorporate into their proposal.

153. Given the variability in the ratio and the new WBWS standard, rather than attempting to create a ratio to set mechanical royalties, it makes far more sense to look to actual agreements for the use of musical works in connection with interactive streaming. [redacted] And services and COs reached agreement on a headline rate and minima in *Phonorecords II*, which the Judges chose to continue in *Phonorecords III*. There is no reason to go through the gymnastics of a ratio, [redacted] and agreements show the terms on which willing buyers and willing sellers agree.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated: April 22, 2022

Elena Segal

Appendix A

Mechanical Royalties as a Percentage of Revenue -- Percent of Revenue Prong

Year	Mo.	Revenue	Performance Royalties	% of Revenue	Subtract Perf	Mech Royalty as % Revenue
[redacted]						

Mechanical Royalties as a Percentage of Revenue -- TCC Prong

Year	Mo.	TCC	Performance Royalties	% of TCC	Subtract Perf	Mech Royalty as % Revenue
[redacted]						

Mechanical Royalties as a Percentage of Revenue - PSM Prong

Year	Mo.	Subscribers	PSM	Mech Royalty % as Revenue
[redacted]				

Mechanical Royalties as a Percentage of Revenue - PPR Prong

Year	Mo.	Plays	PPR	Mech Royalty % Revenue
[redacted]				

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In the Matter of **Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords IV)**	**Docket No. 21-CRB-0001-PR (2023–2027)**

WRITTEN REBUTTAL TESTIMONY OF STEPHEN D. PROWSE, PH.D.

(On behalf of Apple Inc.)

April 22, 2022

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LIST OF EXHIBITS IN THIS REPORT

Exhibit Number	Title
1	Documents Relied Upon
2	Updated Select Apple License Agreements With Publishers and PROs
3	Reproduction of Eisenach Table 4 Using Phono II Rates
4	Reproduction of Eisenach Table 4 Using First Year of Phono III Rates
5	Analysis of Music Streaming Participants
6	UMPG/Songwriter Royalties, 2009 vs. 2020
7	SMP/Songwriter Royalties, 2009 vs. 2020
8	Warner/Chappell/Songwriter Royalties, 2009 vs. 2019/2020

I. INTRODUCTION

A. Assignment and Scope

1. I have been retained by counsel for Apple Inc. ("Apple" or the "Company") to provide opinions in connection with a hearing before the Copyright Royalty Board ("CRB" or "the Board") to determine the royalty rates the streaming Services will pay to Copyright Owners in the *Phono IV* rate proceedings. I previously submitted a report (Written Direct Testimony of Stephen D. Prowse or "the Prowse WDT") on October 13, 2021. On the same date, experts retained by the Copyright Owners as well as other experts retained by the Services also submitted reports. I have been asked to review and analyze the opinions expressed in the following expert reports: Jeffrey Eisenach WDT, Robin Flynn WDT, Daniel Spulber WDT, and Richard Watt WDT. I also reviewed the following reports: Wayne Coleman WDT, Robert Klein WDT, Leslie Marx WDT, Gregory Leonard WDT, Joseph Farrell WDT, and John Hauser WDT. I was also asked to review the WDTs of certain employees of the parties, including Elena Segal (of Apple), as well as respond to certain opinions expressed by J.W. Beekman (Universal Music Publishing Group), Tom Kelly (Sony Music Publishing) and Annette Yocum (Warner/Chappell Music).

2. If a term is not specifically defined in this report, it is intended to have the same definition as in the Prowse WDT. As I did in the Prowse WDT, I refer to the National Music Publishers' Association (which represents Publishers) and Nashville Songwriters Association International (which represents songwriters) collectively as the "Copyright Owners."

B. Information Relied Upon

3. In determining my opinions, I have considered data and information from various sources, all of which are reasonably relied upon by experts in my field. **Exhibit 1** lists the materials I have relied upon in forming my opinions in this action. The documents that I rely upon include documents cited in this report and its exhibits. I have also relied upon my professional experience and expertise obtained over many years as a professional economist. My review of the discovery for these proceedings is ongoing due to the large amount of information produced by the parties. I am prepared to amend my analyses and perform additional analyses

should I consider it necessary after receiving further information relevant to my opinions in this proceeding.

4. Although I may cite to a particular page or pages of documents in this report, such pinpoint cites are provided for clarification purposes only, and other portions of the documents cited may be relevant for my analyses in this matter. In addition, citations to a document or documents are intended to be illustrative and other documents not specifically cited may also support the opinions I express in this report.

C. Summary of Opinions

5. In the Prowse WDT, I explained that the CRB has found that the Willing Buyer/Willing Seller ("WBWS") standard, under which *Phono IV* rates are to be determined, calls for a rate set under competitive terms and without any party exercising substantial market power. I then offered four principal opinions.

6. *First*, I explained that the *Phono II* Settlement, though it was negotiated when the 801(b) factors were the statutory standard, is a reasonable starting point for the CRB to determine royalty rates under the new WBWS standard.[1] The reasons include, among other things, the following:

- The *Phono II* Settlement involved substantial overlap in the licensors and licensees for the same licensed rights as in *Phono IV*.[2] Details of the rates and terms of the *Phono II* Settlement were presented in Exhibit 5 of my original report.
- Market-based evidence shows that willing buyers and sellers have settled on the same rates under both standards. For example, negotiations for *Phono IV* for physical phonorecords and PDDs in 2021 took place under the WBWS standard and continued the same rates that were determined under the 801(b) factors.[3] I understand the Board chose not to adopt these rates, but it is nonetheless relevant to me that NMPA, which represents the publishers, and NSAI, which represents

[1] As noted in the Prowse WDT, "In 2012, the Services and the Copyright Owners reached a settlement on rates and terms of mechanical licenses for years 2013 to 2017 for Streaming Products, and the Judges accepted those rates in 2013 (the "*Phono II* Settlement")." *See* Prowse WDT, fn. 6.
[2] Prowse WDT ¶186, fn 173. I noted there that "NMPA and NSAI were parties to the *Phono II* Settlement, among several other musical work copyright holders."
[3] Prowse WDT ¶¶190-192.

songwriters, agreed to roll forward the *Phono III* rates for Subpart B. The *Phono III* rates were rolled forward from the *Phono II* rates.

- The music industry has experienced substantial revenue growth in the last several years, due largely to interactive streaming.[4] Both record Labels' and Publishers' revenues have gone up significantly over the last few years, including several years during which the *Phonorecords II* rates were in place.[5]

7. *Second*, I explained that including a TCC prong in statutory royalty rates distorts those rates because a TCC prong is based on negotiations between the Services and Labels, and the Labels are not the relevant "willing sellers" in this proceeding (the Publishers and Songwriters are). Moreover, the Labels have substantial, unregulated complementary oligopoly power. The concerns that the TCC prong was meant to address—such as revenue deferral—are better handled through the proper use of minima, adjusted to allow for a wide variety of service offerings and market segmentation.[6] In fact, as I explained, RESTRICTED [redacted]

8. *Third*, I explained that an all-in revenue rate is appropriate because performance rights and mechanical rights are perfect complements and their prices should be determined jointly.[8] An all-in rate protects the Services from the market power the PROs would otherwise wield.

9. *Fourth*, I explained that music streaming revenues for bundles that include music streaming should be calculated using a proportional allocation based on the standalone prices of the components of the bundle. I showed that such an approach is reasonable and mediates between two ends of a spectrum. At one end is the approach adopted in the *Phono II* Settlement, which allocated revenue to non-music streaming services first at their standalone prices and then allocated the remainder to music. This method assumes that purchasers of the bundle have a lower willingness to pay ("WTP") for music in the bundle relative to the WTP for the other

[4] Prowse WDT ¶¶114-115.
[5] While the *Phonorecords III* rates were in place for a portion of this time, from 2015 to 2017 and the latter portion of 2020 into 2021, the 2012 Settlement rates were the statutory standard. The trial rate and per-subscriber minima were also constant throughout this period.
[6] Prowse WDT ¶¶205-278.
[7] *See* **Exhibit 2**.
[8] Prowse WDT ¶¶267-278.

bundle components. At the other end of the spectrum , one assumes that purchasers of the bundle have a higher WTP for music relative to the WTP for the other components of the bundle and use the full standalone music price as revenues subject to royalties. The approach I advocated mediates between these two different approaches and is an approach found in market agreements RESTRICTED .[9]

10. The Copyright Owners, on the other hand, have set forth a royalty structure that is sharply higher than the *Phono II* Settlement rates—and even sharply higher than the *Phono III* rates currently on remand—with no adjustments or flexibility for discounted offerings designed to target low WTP consumers and increase interactive streaming subscribership. The experts for the Copyright Owners attempt to justify these higher rates but their justifications fail.

11. *First*, their arguments are based on a speculative economic theory for which there is no real world evidence: the so-called 'See-Saw' effect, which assumes that the Labels will decrease their royalties in response to an increase in Publisher royalties. The evidence indicates that there is no See-Saw effect.

12. *Second*, the Copyright Owners' experts attempt to justify the rate increase by pointing to supposedly hidden complementary income that Services can use to pay higher publisher royalties.[10] According to the Copyright Owners' experts', complementary income refers to income from other (complementary, non-music) businesses that is *driven by* (a result of) music subscriptions. The Copyright Owners' experts do not point to any evidence of such complementary income across the Services, nor do they take account of the fact that complementary income effects also flow in the opposite direction, (*i.e.*, from non-music businesses to music streaming revenues) from which the Copyright Owners benefit. Further, there are many pure-play services, and setting rates high enough to account for such complementary income would likely make the pure plays unwilling buyers.

13. *Third*, they claim there is asymmetric information between the Services and the Labels and the Labels cannot even guess at this supposed complementary income. Under the Copyright Owners' experts' theory, if the Labels did know of the existence of this complementary income, then the Labels would make an estimate of it and extract it during their negotiations with the

[9] Prowse WDT ¶295.

[10] The different Copyright Owners' experts are not consistent in their terminology. Eisenach uses the term 'complementary' income; Watt uses the term 'parallel' or 'displaced' income.

Services. The Copyright Owners' assertion that the Labels cannot estimate what the Copyright Owners' experts believe is self-evident is manifestly implausible.

14. *Fourth*, the experts for the Copyright Owners also claim to use "market-based benchmarks" and a Shapley modeling analysis to support their proposed rates and the application of a 2.5:1 ratio of Label royalties to musical works royalties. But these "benchmarks" are largely non-comparable audio-visual agreements and Label agreements. And the Shapley model they use is a deeply flawed model for this proceeding and cannot be used to determine effectively competitive market rates.[11]

15. I organize my report into six broad categories. (1) I briefly describe Apple's proposal and explain that it is consistent with the WBWS standard, with its agreements with Publishers and PROs, and with industry trends. By contrast, the rates and rate structure the Copyright Owners propose do not reflect appropriately comparable license agreements. (2) I show that the Copyright Owners have proposed rates that would sharply increase royalties–far higher than the *Phono III* rates currently on remand. (3) I examine the economic reasoning that the Copyright Owners' experts have offered for such sharp increases and show that it is flawed. (4) I examine the Shapley analysis and benchmarks that the Copyright Owners claim support the 2.5:1 ratio. (5) I examine the Copyright Owners' arguments that statutory rates should be set at a premium to account for purported regulatory lag and error. (6) I examine the Copyright Owners' claim that interactive streaming has failed to offset the decrease in royalties from physical sales and downloads.

16. I continue to be of the opinion that the *Phono II* Settlement is a reasonable starting point for a determination of rates under the WBWS standard, that the TCC prong is inconsistent with the WBWS standard, and that Apple's directly negotiated deals with Publishers and PROs are strong benchmarks RESTRICTED.

II. APPLE'S PROPOSAL IS CONSISTENT WITH THE WBWS STANDARD AND RESTRICTED

17. As noted in the Prowse WDT, some key features of the Apple proposal are:[12]

[11] In the Prowse WDT at fn 207 I provided cites to how the Judges have defined 'effective competition.'

[12] Prowse WDT ¶22; *also see* Apple Proposal, §385.2 and §385.21(b)(3)(ii) in Apple's Amended WDS. *Also see* Testimony of Elena Segal, *In re Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords IV)*, Docket No. 21-CRB-0001-PR (2023-2027), ¶ 105 (henceforth, "Segal WDT").

- A revenue-based rate structure for all-in rates without a prong based on "Total Cost of Content" ("TCC prong");
- Tiered per subscriber minima ("PSM") to address revenue deferral concerns with discounts and adjustments for family plans, student plans, and trials;
- All-in royalty pools with a deduction for performance royalties to determine the mechanical royalty pool;
- Music revenue from bundled subscriptions should be based on a proportional allocation of the budle revenue with the proprotion based on the ratio of the standalone price of the components of the bundle relative to the bundle price; and
- For hardware bundles, given the difficulty in measuring applicable monthly revenue due to a one-time payment, a per subscriber minimum of 33 cents per month for the first two years.

18. Apple has not taken a position on the specific headline revenue rate, proposing to have it be the same as the headline rate the Judges ultimately set in *Phonorecords III*.[13]

19. In Exhibit 6 of the Prowse WDT, I presented a RESTRICTED [redacted] These agreements RESTRICTED [redacted] I have updated what was Exhibit 6 in the Prowse WDT and attached it to this Report as **Exhibit 2**.

III. COPYRIGHT OWNERS PROPOSE ECONOMICALLY UNREASONABLE ROYALTY RATES AND A RATE STRUCTURE (AND TERMS)

20. The Copyright Owners' proposal includes the following:

a. Proposed rates that would lead to a striking increase in royalties.

b. Proposed rates and terms that contain no discounts for family and student plans or limited functionality offerings.

c. Proposed rates and terms that contain no proportional allocation for bundles.

d. Proposed rates and terms that contain no free trial period.

[13] Amended Introductory Memorandum to the Written Direct Statement of Apple Inc at 3. Apple notes that the sole exception is that Apple proposes to retain a 12% headline rate from *Phonorecords II* for paid music lockers.

e. Proposed rates and terms that contain an uncapped TCC prong as well as other unnecessary prongs.

f. Proposed royalties that are calculated as the *maximum* of several prongs, RESTRICTED [redacted] as well as the Copyright Owners' previous testimony.

A. The Copyright Owners Have Benefitted Under the Current Rate Regime

21. In the Prowse WDT, I showed that streaming has been an engine of growth for the music industry. Among other things, I explained that:

- Music industry revenues have been increasing since the *Phono II* Settlement, increasing at an annual average rate of 10.8% between 2015 and 2020.[14] While the *Phonorecords III* rates were in place for a portion of this time, from 2015 to 2017 and the latter portion of 2020, the *Phono II* Settlement rates were the statutory standard. The trial rate and PSM were also constant throughout this period.
- Interactive streaming has been the engine of growth for the industry, growing at an average annual rate of 38.5% since 2009.[15]
- Streaming has helped the market to expand for the first time since 1999.[16]
- Paid subscription streaming services are the principal driver of streaming growth.[17]
- Streaming has more than offset the slight decline in digital downloads and CDs.[18]

22. I also explained in the Prowse WDT that Publishers and Labels have realized significant gains in revenues as streaming has grown. Between 2014 and 2020, Publishers have realized a gain in revenues that has averaged 9.2% per year and are benefiting from an increased ability to monetize their catalogs.[19] The Labels have grown at an annual average rate of 7.7% from 2014 to 2020 and are expected to grow at an annual rate of 7% until 2030.[20]

23. In short, under the current rate regimes, the Copyright Owners have benefited from the rates established in the *Phono II* Settlement and the minima that have been in place since then.

[14] Prowse WDT ¶115.
[15] Prowse WDT ¶116.
[16] Prowse WDT ¶116.
[17] Prowse WDT ¶119.
[18] Prowse WDT ¶122.
[19] Prowse WDT ¶¶125-6.
[20] Prowse WDT ¶¶127-9.

B. Copyright Owners Propose Sharply Higher Royalty Rates

24. The Copyright Owners have set forth sharply higher proposed royalty rates with the following rate structure and rates for *Phono IV*.

TABLE 1:
Copyright Owners' Proposal

	Phonorecords II	***Phonorecords III***	**Copyright Owners' Proposed Rates**
Musical Works % of Revenue	10.5% - 12%	11.4% - 15.1%	20.0%
Musical Works % of TCC	20.65% - 22%	22% - 26.2%	40.0%
Free Trial Period	yes	yes	no
Tiered Per Subscriber Minimum	yes	yes	no
Mechanical-Only Per Subscriber	$0.15 - $0.50	$0.15 - $0.50	$1.50
Mechanical-Only Per Play	N/A	N/A	$0.0015

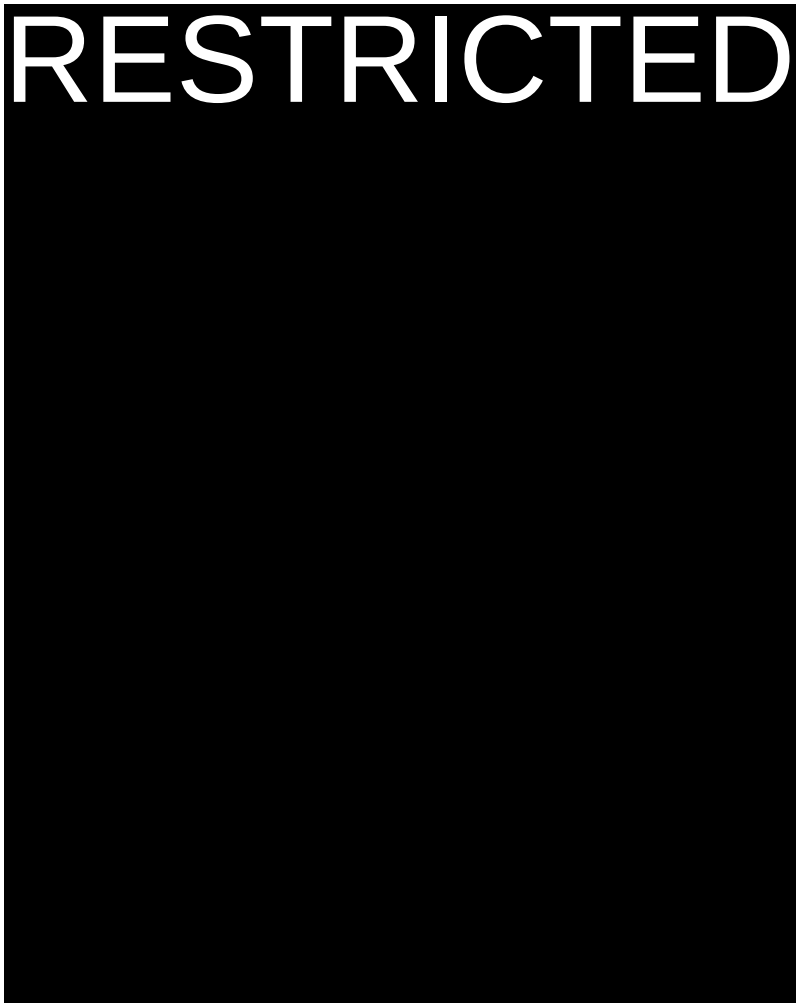
Sources: Eisenach WDT, Table 2; Phono III Final Determination; Prowse WDT.

25. Each element of this proposal would increase rates—in some cases, sharply—above the initial *Phono III* rates currently on remand and the current statutory *Phono II* rates.[21] For a point of comparison, the Judges found in their *Phono III* Final Determination that a 44% increase in the headline rate in *Phono III* compared to *Phono II* (15.1% compared to 10.5%) was substantial.[22] The increase the Copyright Owners propose is vastly higher than this.

26. Under the Copyright Owners' proposal, the revenue rate for standalone portable subscriptions is **90%** higher than the comparable *Phono II* rate and **75%** higher than the initial *Phono III* rate. The TCC prong is **90%** higher than the *Phono II* rate for standalone portable subscriptions and **82%** higher than the initial *Phono III* rate. The PSM is **200%** to **900%** higher than in the *Phono III* and *Phono II* rates. There would also be a new PPR prong. And, unlike the terms of the *Phono II* Settlement, the Copyright Owners propose to take the maximum of each of these prongs for every service offering. In combination, these increases and new prongs would produce substantial increases in the royalties paid. Eisenach himself presents these calculations and they show strikingly high increases in royalties.

[21] As I note later in the text, RESTRICTED .
[22] *Phono III* Final Determination at 88.

27. This can be seen from Eisenach's Table 4. (In the table below P3 refers to the royalties that would result from applying *Phono III* rates.)



28. Eisenach's calculations show RESTRICTED under the Copyright Owners' proposal—and this is compared to the *Phono III* rates. Using Eisenach's data (which spans the period June 2020 to May 2021, *see* Eisenach WDT at 5) but with *Phono II* rates and terms (with no adjustment for student and family discounts) shows that Apple would pay RESTRICTED more under the Copyright Owners proposal.[23] If one uses Apple's actual data, the increase is greater still: RESTRICTED higher under the Copyright Owners' proposal.[24]

[23] *See* **Exhibit 3**

[24] Apple accrued RESTRICTED in musical works royalties from July to December 2020 RESTRICTED. APL-PHONO4_00000472. Using Eisenach's calculations for the same period, under the COs' proposal, Apple's musical works royalties would have been RESTRICTED during that time, an increase of RESTRICTED

29. It is also misleading to use the final year of the *Phono III* rates as a point of comparison. Eisenach compares the proposed headline rate of 20% to the highest *Phono III* rate of 15.1%, implicitly ignoring that (1) the rate is only 11.4% in the first year, and (2) the rate was vacated on appeal. Similarly, the TCC rate is 22% in the first year of Phono III rates, rising to 26% only after five years. In other words, Eisenach compares the Copyright Owners' rate proposal to a 15.1% headline rate and a 26.2% TCC rate that no one has ever paid. Using the first year of the *Phono III* rates as the point of comparison (instead of the final year) the Copyright Owners proposal would produce an increase in Apple's royalties from RESTRICTED (as shown in **Table 2** above) to RESTRICTED.[25]

30. The magnitude of the increase that the Copyright Owners are proposing can also be seen in another of Eisenach's tables. Below is a reproduction of Eisenach's Table 5**.**

RESTRICTED

31. Here Eisenach calculates what percentage of their revenues Services would pay in royalties under the Copyright Owners' proposal after adding in the royalties they owe Labels. This is shown in the second to last column on the right. Instead of paying total interactive

[25] *See* **Exhibit 4**.

streaming royalties (musical works plus sound recording) of about [redacted] the Copyright Owners' own expert calculates that Apple would pay more than [redacted] of its revenues as royalties.[26] While this alone is striking, in fact, the true number is even higher. Over the first half of 2021, under the Copyright Owners' proposal, Apple would pay an amount that RESTRICTED [redacted] per month.[27] Amazon and Pandora would pay RESTRICTED of their revenues in royalties for their ad-supported services.

32. Just as striking as the amount of these increases are the speculative justifications the Copyright Owners' experts offer for them, which I explain in more detail below.

C. Copyright Owners' Lack of Discounted Offerings and Pricing Tiers Is Not Economically Reasonable

33. Copyright Owners propose no student, family, or limited offering discounts. This is not economically reasonable given that these discounts largely align the interests of Copyright Owners and Services in growing the music streaming market. It is also widely accepted that royalties that allow for price discrimination benefit both the Services and the Copyright Owners.[28] In my WDT, I documented the growth in U.S. music publishers' royalties alongside the expansion of interactive streaming from 2013 to 2020.[29]

1. Student and family discounts benefit both Services and Copyright Owners

34. The Judges previously recognized that student and family discounts are an effective form of price discrimination.[30] In *Phono III*, the Judges noted that "the only survey evidence in the record suggest[ed] that listeners to streaming services have RESTRICTED

[26] The Segal WDT at ¶55 shows that Apple pays an effective royalty rate of [redacted] in sound recording royalties. [redacted] plus the [redacted] shown by Eisenach's Table 5 results in a total of [redacted]. Eisenach himself shows in Table 5 that Apple would pay combined royalties of [redacted]

[27] Rebuttal Testimony of Elena Segal ¶ 22.

[28] *Phono III* Final Determination at 84-85 ["Price discrimination not only serves low WTP listeners, but it also indirectly serves Copyright Owners, by incentivizing interactive streaming services to increase the total revenue that price discrimination enables. … An upstream rate structure based on monetizing downstream variable WTP will facilitate beneficial price discrimination."] The classic reference for price discrimination is Pigou, Arthur The Economics of Welfare 4th Ed. 1932.

[29] *See generally* Prowse WDT, Section II.C.4.

[30] "[T]he Judges also recognize that marketing reduced rate subscriptions to families and students is aimed at monetizing a segment of the market with a low WTP (or ability to pay) that might not otherwise subscribe at all." *Phono III* Final Determination at 90.

RESTRICTED ”[31] The D.C. Circuit affirmed the CRB's conclusions that student and family discounts were grounded in the evidence.[32]

35. Elena Segal, Global Senior Director of Music Publishing at Apple, has explained that student and family discounts are a key source of Apple Music's growth and produce shared benefits for Apple, its subscribers, and the Copyright Owners.[33] Student and family discounts monetize low-WTP consumer segments thus diverting them from distribution channels that generate lower or no royalties (*e.g.*, free streaming, piracy), she writes.[34] Both types of discounts also prove the value proposition of premium streaming services thereby increasing retention rates (*i.e.*, reducing "churn"). Family discounts introduce younger consumers (family members) to music consumption via streaming and increase the likelihood that they will pay for music over their lifetimes.[35] Similarly, student discounts introduce students to music consumption via streaming and increase the likelihood that students will pay for music – and at a higher price – after they graduate.[36]

36. Other Services have offered similar testimony.

- "Amazon Music offers the Family Plan option to reach more customers; a family of 4 typically is not willing to pay $40 for 4 separate streaming subscriptions."[37]
- "Amazon Music offers the Student Plan to reach more customers; students typically have less disposable income and therefore lower willingness to pay."[38]
- RESTRICTED [39]
- "Spotify's Student Plan has proven extraordinarily successful at capturing a particular segment of lower willingness-to-pay consumers: students. In the U.S., the Student Plan, priced at $4.99 a month, RESTRICTED ."[40]
- Counting Student Plans as 0.5 subscribers and Family Plans as 1.5 subscribers "provides an incentive to services to offer discounted plans to users who otherwise might not be

[31] *Phono III* Final Determination at 52.
[32] George Johnson v. CRB 8/7/20 at 57-58.
[33] Segal WDT ¶¶ 19-22, 30.
[34] Segal WDT ¶¶ 21-22.
[35] Segal WDT ¶ 21.
[36] Segal WDT ¶ 22.
[37] Hurwitz WDT ¶ 12.
[38] Hurwitz WDT ¶ 13
[39] Kaefer WDT ¶ 17.
[40] Kaefer WDT ¶19.

willing to pay for a subscription—and money in the pockets of songwriters that might not otherwise be earned."[41]

- "By creating different price points, you access users that wouldn't otherwise subscribe. So students who have a smaller budget, as long as they are still students, having a student plan that is at a discount, it allows them to be a paying customer, teaches them about paying for music, builds that habit, and then when they graduate and enter the workforce or, you know, society generally, then they upgrade, you know, more -- more naturally into being -- paying a standard price. Similar with family plans, you know, you have children in the -- in the home that are not necessarily going to have their own subscription, we can get -- add to the overall revenue pie, also engage with listeners at a younger age or an older age. We actually see family plans used for grandparents and such as much as we see it used for kids. People who we can add to the subscription roles who wouldn't necessarily do their own subscription. Now, the -- a side benefit of that is we're monetizing an audience that's extremely hard to monetize in an ad environment. So, you know, from a business perspective, you get two benefits. You get the benefit of -- of monetizing in a subscription environment an audience that would otherwise not subscribe. So you're adding incremental subscribers to the pool. That's good. Second is you're targeting those incremental subscribers out of pools that are hard to monetize anyway, 13- to 17-year-olds, really hard to monetize with advertising; 55 and older, really hard to monetize from advertising. So those are two pools that, if we can convert as many of them as we can in subscription, that's good for both us as a business, but also for copyright holders as it increases their overall royalty payments."[42]

37. As I documented in my WDT, student and family discounts are featured RESTRICTED [redacted][43] Many of these contracts were negotiated against the backdrop of the WBWS standard.[44] I have updated Exhibit 6 from the Prowse WDT (**Exhibit 2** to this Report) with RESTRICTED [redacted]

38. RESTRICTED [redacted] These agreements provide additional evidence of the shared benefits such discounts provide. That they are common in negotiated agreements also provides additional evidence that such discounts conform to the WBWS standard.

[41] White WDT ¶41.
[42] Herring *Phono III* WDT (transcript attached: 892:20-894:8).
[43] Prowse WDT, Exhibit 6. *See also* Segal WDT ¶¶122,130.
[44] Prowse WDT ¶280.
[45] *See, e.g.*, Higginson WDT ¶¶ 97, 99; Bonavia WDT ¶¶ 52-55.

2. Pricing Tiers Benefit Services and Copyright Owners

39. Under the Copyright Owners' proposal all types of Services must pay the same per-play rate and all subscription services must pay the same per-user rate. This is economically unreasonable since the proposal fails to include pricing tiers for limited functionality offerings. Pricing tiers have been engrained in the royalty rate since at least the *Phono II* Settlement, which included adjustments to minima for non-portable services and other products.[46] It is important to retain differentiated minima to allow for continued product differentiation, RESTRICTED [redacted].[47]

40. Apple, for example, launched a new limited functionality plan after I filed my WDT. This plan helps attract consumers to interactive streaming who might otherwise be unwilling to pay for a $9.99 subscription service. This plan, by design, offers limited functionality in exchange for a lower price: it is voice-activated only and does not allow consumers to download music, listen to songs in spatial audio, or listen to the full catalog in lossless audio, among other things.[48] Apple uses its voice-only plan to capture a segment of the market that would otherwise not engage with paid streaming. Just as non-portable services in the past had a discounted per-user rate to attract low WTP customers, so does Apple's voice plan.

41. The Copyright Owners' proposal would not incentivize this type of innovation. Rather than increasing the discount tiers to facilitate increased segmentation, the Copyright Owners unreasonably propose eliminating these incentives from the rate structure.

42. There is no economic justification for the elimination of all discounts for limited functionality plans. RESTRICTED [redacted] As shown in **Exhibit 2**, the PROs, RESTRICTED [redacted]

[46] *See Phono II* Motion to Adopt Settlement, section 385.13, at 10-13.
[47] *See, e.g.,* Hurwitz WDT ¶ 51 (explaining the benefit of the Echo Single Device Plan); Segal WDT ¶ 28.
[48] *See* https://www.apple.com/apple-music/. Spatial audio is an Apple innovation that if offers to premium subscribers under its Student, Individual and Family Plans and is an immersive listening experience.
[49] SME (APL-PHONO4_00001700 at 1704), WMI (APL-PHONO4_00001680 at 1685), UMG (APL-PHONO4_00009631 at 9638, 9685).
[50] *See* **Exhibit 2** for the PRO agreements.

D. Copyright Owners' Proposal Regarding Bundled Subscription Services Is Not Economically Reasonable

43. The Copyright Owners propose to use the definition of music service revenue for bundled subscription offerings from the vacated *Phono III* decision. According to this definition, music revenues from a bundle are defined as the standalone price of music, so Services would pay the same royalties as they would even if the music service was not part of the bundle.[51] This proposal is not economically reasonable and reduces the incentive to include music in bundles, which are an important tool for attracting users to interactive streaming.

44. As I explained in my WDT, the *Phono III* revenue attribution formula implicitly assumes that buyers of bundles have a higher WTP for interactive streaming relative to the other products in the bundle.[52] Thus, I explained that the *Phono III* formula is *ad hoc* and subjective, and represents one of two very different approaches to revenue allocations for bundles.[53] In the other approach, the non-streaming components of the bundle are valued at their standalone prices and any remaining value is attributed to music streaming.[54] Apple's proposal, which defines streaming revenues based on all the components in proportion to their standalone prices, not only strikes a reasonable balance between these two approaches, it does not depend on an assumption that music is the sole driver of the purchased bundle. Many listeners are unwilling to pay for a music streaming service on a stand-alone basis but are willing to do so if it is part of a bundle.[55] Bundles increase subscribership and, thus, revenue for Services and royalties for Copyright Owners.

45. Apple's witness, Ms. Segal, testified that bundles "help attract low willingness-to-pay consumers and new consumers."[56] Spotify's witness, Mr. Kaefer, testified that bundles "are

[51] Eisenach WDT ¶174.
[52] Prowse WDT ¶ 290.
[53] Prowse WDT ¶ 291. The other approach is the *Phono II* Settlement's rule of calculating music revenue as the price of the bundle minus the standalone prices of all non-music components of the bundle. Prowse WDT ¶ 289.
[54] Prowse WDT ¶¶ 293, 296.
[55] Segal WDT ¶23.
[56] Segal WDT ¶ 23.

another way to price discriminate and capture low willingness to pay consumers for Spotify's Premium Service. [redacted].”[57]

46. This effect can be seen in evidence from Apple's bundle, called Apple One. In Apple One, consumers are charged 71% of what they would pay to subscribe to all of the services in the bundle on a standalone basis.[58] This means that revenues from the streaming portion of the bundle, for purposes of calculating the revenue base for royalties, would be $7.09/month (71% of $9.99). This is less than the full price of streaming of $9.99 but if the bundle creates new users, then this must also be taken into account. And in fact, [redacted] of Apple One subscribers are new to music.[59] This means that under Apple's bundle, for every 100 subscribers, [redacted], and generate incremental revenues of [redacted]. At the same time the other [redacted] users, not new to music, would cause a reduction in revenues of [redacted]. Overall, there is a net increase in revenues (in this example) of [redacted]. Moreover, this plan has reduced churn and promoted the Apple Music plan, which has benefited Copyright Owners further.[60] Apple's proposal with respect to bundling creates the right economic incentives to encourage the creation of these revenue-enhancing bundles—which benefit the Copyright Owners as well as Apple.

47. Eisenach argues for Copyright Owners' proposal to maintain the *Phono III* definition of music service revenue for bundled subscription offerings.[61] He claims that "any measurement approach would be bundle-specific and so would not appropriately form the basis for a universal rule for calculating bundle revenue."[62] But whether the Board adopts the Copyright Owners' proposal, Apple's proposal, or another proposal, it would be setting a universal rule. In other words, the Copyright Owners are *also* proposing a universal rule for measuring revenue: a rule

[57] Kaefer WDT ¶ 62.
[58] Segal (Amended WDS, 3/8/22, ¶¶ 24-25. The basic Apple One bundle consists of Apple Music, Apple TV+, Apple Arcade and storage in the cloud. There are variations on this basic plan for families and additional storage.)
[59] Rebuttal Testimony of Elena Segal ¶ 60.
[60] Rebuttal Testimony of Elena Segal ¶ 60.
[61] *See generally* Eisenach WDT, Section VI.D.
[62] Eisenach WDT ¶ 177.

where interactive services that are part of a bundle are treated the same as interactive services that are not part of a bundle. This is a poor solution because it assumes that Copyright Owners never benefit from bundles, which, as just described, is not the case. Adopting this approach also decreases the Services' incentives to include interactive music streaming services in bundles, because they would receive a discounted payment from consumers, but still have to pay full mechanical royalties to Publishers. The bundling rule proposed by the Copyright Owners, as a result, would give the Services less incentive to bundle interactive streaming with other services that might draw consumers to music streaming who would not otherwise subscribe. Apple's proposal is all the more appealing because this proceeding sets a universal rule. It takes into account that for some consumers buying bundles, music may be the driver, but for other consumers, other products may be the driving force behind subscribership.

48. An allocation of bundle revenue that results in less than the full standalone price of a music subscription RESTRICTED [redacted] *See* **Exhibit 2**. RESTRICTED [redacted] The revenue attribution rule under the *Phono II* Settlement subtracted the standalone prices of all non-music components of the bundle, which typically differ by the bundle.[64] Crucially, that rule was the product of a negotiated settlement that approximated a WBWS negotiation, as I explained in my WDT.[65] Dr. Eisenach, on the other hand, does not cite a single license agreement as support for the rule the Copyright Owners propose.

E. The Lack of Discounts for Free Trials is Not Economically Reasonable

49. The Copyright Owners' proposal does not permit discounts for the PSMs to account for free trial periods. This is not economically reasonable because free trials are an important source of new subscriptions that benefits both Copyright Owners and Services by bringing in paying subscribers to interactive streaming who might have otherwise not joined.

[63] *See, e.g.*, White WDT ¶ 45.
[64] Prowse WDT ¶ 289.
[65] *See generally* Prowse WDT, Section V.A.

50. Amazon reports that "[RESTRICTED]"[66] Kaefer (Spotify) says that free trials are "[RESTRICTED]"[67] According to Kaefer: "[RESTRICTED]"[68] Kaefer reports that [RESTRICTED].[69] Robert Klein found that [RESTRICTED] of respondents to his survey found the free trial period to be "Very important" or "Somewhat important" in their decision to subscribe.[70]

51. Agreements that the Services have negotiated with Publishers and Labels also contain discounts to the PSM to reflect free trials. [RESTRICTED].[71] [RESTRICTED]"[72] [RESTRICTED].[73] Higginson (Google) cites [RESTRICTED].[74] The *Phono II* Settlement also contained a zero-royalty period.[75]

52. Zero-royalty periods or other discounts during free trials, in sum, are economically reasonable and [RESTRICTED]

[66] Hurwitz ¶84.
[67] Kaefer WDT ¶20. [fn omitted]
[68] Kaefer WDT ¶20.
[69] Kaefer WDT ¶13. [fn omitted]
[70] Klein WDT Table 24.
[71] Segal (Amended WDT) ¶130.
[72] Bonavia WDT ¶43.
[73] Bonavia WDT ¶¶43-45.
[74] Higginson WDT ¶89.
[75] *See Phono II* Motion to Adopt Settlement, section 385.14, at 13 and 16.

RESTRICTED. The Copyright Owners' experts do not cite any agreements that support their proposal to exclude free trials.

F. An Uncapped TCC Prong is Not Economically Reasonable

53. Before I explain why an uncapped TCC prong is not economically reasonable, I explain why a *capped* TCC prong introduces problems into the rate structure. A capped TCC prong (i.e., capped by a PSM), as I explained in the Prowse WDT, is unnecessary and introduces distortions into the WBWS standard. I showed that:

- A TCC prong imports into the royalty structure the complementary oligopoly power of the Labels.[76]
- A TCC prong reflects the bargaining power of the *Labels* relative to the Services and does not conform to the WBWS standard, which requires an analysis of the rates willing buyers (Services) and willing sellers (Publishers) would agree to.[77]
- The extent of this differential in bargaining power cannot be reliably measured, so it cannot be adjusted to produce reliable results for the TCC prong parameters.[78]
- A TCC prong permits the preferences of the Labels for one Service over another to affect musical works royalties.[79]
- An *uncapped* TCC prong exacerbates all of these problems and is even less appropriate under a WBWS standard. Unlike some interactive streaming companies, RESTRICTED [redacted][80]

54. Experts for the Copyright Owners argue that a TCC prong protects against revenue deferral and displacement.[81] But similar protection can be obtained by setting minima at appropriate levels, as I explained in the Prowse WDT.[82] Eisenach also says that the TCC prong permits rapid adjustment to changing market conditions and the five year statutory period term is too long to make rapid adjustments. But he does not specify what market conditions he means. [83]

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[76] Prowse WDT ¶¶210-218.
[77] Prowse WDT ¶¶220-30.
[78] Prowse WDT ¶¶231-35.
[79] Prowse WDT ¶207.
[80] Prowse WDT ¶239.
[81] The *Phono III* Determination at 36 echoes this argument.
[82] Prowse WDT ¶¶247-255.
[83] Eisenach WDT fn 104 citing Brodsky, who also does not specify what market conditions he (Brodsky) means.

As I explained in the Prowse WDT, the market has been growing substantially, as have revenues for publishers and Labels. Moreover, Eisenach seems to assume that Label agreements change rapidly when [redacted].[84]

55. There also may be reasons for sound recording royalties increase that have nothing to do with musical works copyrights. For example, I understand that one new feature in interactive streaming is the delivery of audio with superior sound quality. The Publishers do not make any contribution to creating recordings with better sound quality, whereas the Labels are responsible for creating and delivering these higher quality recordings. Therefore, while the Labels may earn a change in royalties for providing a better quality product, there is no reason Publishers should also get an increase in royalties. But that is what happens by linking the two with a TCC prong.

56. In addition, because the Copyright Owner experts have not shown the presence of hidden complementary income from interactive streaming that the Labels cannot see and extract (under their theory), it is implicitly contradictory for them to argue for both an uncapped TCC prong and a See-Saw effect. Under Watt's reasoning[85] (which Eisenach adopts[86]), if the See-Saw effect is correct, then an increase in the musical works headline rate should necessarily lead to a decline in sound recording royalties. On the other hand, the TCC prong forces the musical works royalties and sound recording royalties to move in the same direction. Yet the Copyright Owners experts argue for both anyway.

[redacted]

[85] *See* Watt WDT ¶¶76-77. Watt describes what would happen if additional surplus became known to the negotiating parties—they will include it in the negotiation. And as the Judges have noted, what Watt means by this is that "if you increase the statutory rate, the bargained sound recording rate will go down." *Phono III* Final Determination at 73-74 (citing Watt's trial testimony). Watt also describes a situation in which the bargaining power of the parties changes when this additional surplus is revealed. But he does not explain how this change in bargaining power comes about so it is nothing more than speculation.

[86] Eisenach WDT ¶84.

[87] Segal WDT ¶120.

RESTRICTED [8]

58. For the foregoing reasons, a TCC prong is not economically reasonable—and uncapped TCC prong even less so. Without a PSM as a backstop, an uncapped TCC prong unreasonably ties musical works royalties to the royalties of the Labels, who have a high degree of market power and who may provide benefits that Publishers do not. An uncapped TCC prong is inconsistent with the WBWS standard.

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59. The Copyright Owners propose to calculate the *maximum* of the various prongs they propose. This is inconsistent with the WBWS standard because RESTRICTED do not contain such a calculation.[89] This proposal is also inconsistent with the previous testimony of the Copyright Owners. As the CRB noted, the Copyright Owners have previously argued for a per play rate ("PPR") on the grounds that it provides transparency and simplicity, that it prevents 'manipulation' of revenues through bundling, discounting, and revenue deferral and displacement and that a rate structure with the usual 'greater than' and other prongs is cumbersome and convoluted.[90] But now they argue not just for a PPR but also for these "cumbersome" alternative prongs.

IV. THE COPYRIGHT OWNERS' PROPOSAL DEPENDS ON THREE HIGHLY SPECULATIVE THEORIES

60. The Copyright Owners attempt to justify these radical changes to royalty rates and terms using three theories. First, they argue that the negotiations between the Labels and Services necessarily take place under a *'See-Saw' effect*. Second, they claim that the Services have significant '*complementary income*'—they claim music drives income in other non-music businesses. Third, they claim that the Labels are oblivious to the existence of this complementary income—and hence cannot extract it during their negotiations with the Services. As I explain below, none of these theories is correct and none can justify the radical increases in rates the

[88] Segal WDT at ¶129. *See* also **Exhibit 2.**
[89] I am not aware of any agreement that contains such a calculation and Eisenach does not point to any.
[90] *Phono III* Final Determination at 15-16; Dissent at 42-43.

Copyright Owners propose. The theories are either (i) lacking in evidentiary support, (ii) directly refuted by the available evidence, or (iii) patently implausible, or a combination of these three.

A. THE SEE-SAW THEORY IS IMPLAUSIBLE AND THE EVIDENCE CONTRADICTS IT

61. The Copyright Owners' proposal is based on, among other things, a speculative theory—the See-Saw theory that the CRB adopted in its Final Determination in *Phono III* (now on remand) and elaborated in its December 9, 2021 Order. According to the See-Saw theory, one first determines the amount of royalties the Services should be permitted to keep and then divides the remainder between the Copyright Owners and the Labels based on what the ratio of sound recording royalties to Copyright Owners should be.[91] As explained below, there is no support for the See-Saw theory.

62. The See-Saw theory rests first of all on a claim about the outcome of negotiation between the Services and the Labels. According to the Copyright Owners, in a negotiation between the Services and the Labels, the Labels, due to their market power, will extract all the available surplus, leaving the Services with little to none.[92] If the musical works royalty rates increase—that is, if the Services pay more to Publishers—the Labels will necessarily have less to extract from the Services. The theory predicts that the Labels will demand less in a negotiation with the Services. As a result, the Copyright Owners claim the royalties will 'See-Saw,' rising for the Publishers and decreasing more or less in lockstep for the Labels.[93] The See-Saw theory depends on this dollar for dollar See-Sawing. This is because, under the theory, all the available surplus has already been extracted from the Services in their negotiations with the Labels. If there is subsequently less available surplus because the musical works royalties increase, and if the Labels are intent on allowing the Services to have just enough surplus to survive, then they must accept less in royalties to continue allowing the Services to survive. The Services are, in other

[91] Notice and Sua Sponte Order Directing the Parties to Provide Additional Materials, In re Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), Docket No. 16-CRB-0003-PR (2018-2022) ("the December 9, 2021 Order") describes this process.
[92] Watt WDT ¶76; December 9, 2021, Order at 2 ["The Copyright Owners' experts testified that the Majors will set royalty rates that allow the Majors to acquire all of the surplus generated in a Shapley Value Model, less any of that surplus Copyright Owners might acquire if the mechanical royalty rates set by the Judges were high enough to allow them to acquire a portion of that surplus."]
[93] As the *Phono III* Final Determination notes, citing Watt's trial testimony, "if you increase the statutory rate, the bargained sound recording rate will go down." *Phono III* Final Determination at 74.

words, just barely willing buyers. An increase in Publisher royalties would necessarily make them unwilling buyers without an equal offset in sound recording royalties.

63. One of the most glaring problems with the See-Saw theory is the Copyright Owners experts' assumption that the Labels will acquiesce and simply reduce their royalty rates. The *Phono III* Dissent noted that, "There is absolutely no evidence that such a significant shift in royalty distribution would occur, nor is there sufficient evidence as to the potential consequences of such a draconian reallocation of revenue."[94] Since the Dissent was written there has been additional testimony from RESTRICTED and RESTRICTED .

64. For example, RESTRICTED .[95] She writes that:

> "Significantly, never once during these negotiations did the Majors RESTRICTED Instead, the Majors seem focused exclusively RESTRICTED "[96]

65. She further explains that RESTRICTED

66. There is also testimony from RESTRICTED which states

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[94] *Phono III* Dissent at 9.
[95] Segal WDT at ¶¶ 69, 72 ["Labels can extract RESTRICTED from services due to their market power. This principle is important to understanding why labels have not and likely will not in the future RESTRICTED To the extent they have RESTRICTED
[96] Segal WDT, ¶76.
[97] Rebuttal Testimony of Elena Segal ¶26.

RESTRICTED

[redacted]

[redacted]."[98]

67. He explains that:

"…

RESTRICTED

[redacted]

[redacted]

[redacted]."[100]

RESTRICTED

[redacted]."[101]

[98] Bonavia WDT, ¶31.
[99] Bonavia WDT, ¶32.
[100] Bonavia WDT, ¶33.
[101] Bonvaia WDT, ¶35.

68. RESTRICTED

RESTRICTED

69. RESTRICTED

.”[102] RESTRICTED

.[104]

70. Besides the simple fact that the Labels just do not appear to be willing to reduce royalties as a result of increases in Publisher royalties, there are other reasons that explain why it is unrealistic to expect the See-Saw effect to work in the real world. One such reason is RESTRICTED

[102] White *Phono III* WDT (remand) ¶4-5. [“In short, the drop in sound recording rates predicted by the Judges—the so-called ‘see-saw’ effect that undergirded the change in rate structure and levels—has not occurred for Pandora.”]

[103] Diab WRT at ¶9 RESTRICTED

[104] Mirchandani *Phono III* WST, ¶14. RESTRICTED

[105] Lundberg WDT ¶12 (footnote cites agreements Spotify had with UMG, Sony, Warner Music.)

RESTRICTED [redacted]

> "It also is not possible to quickly change royalty rates with Majors in the event publishing royalties increase. The agreements with the Majors reflect a constellation of RESTRICTED [redacted] Apple cannot quickly flip a switch and suddenly have new deals with Majors if publisher costs increase. It has no leverage to get anything from labels between the two-year deal cycles."[107]

71. For all these reasons, the See-Saw theory is little more than an exercise in speculation. It lacks supporting evidence and is inherently implausible. The Copyright Owners experts appear to recognize the risks of relying on the See-Saw theory and attempt to circumvent these contradictions by arguing that the Services have an additional income they receive from their complementary businesses that is driven by their music streaming business, and this income is hidden from the Labels. But these arguments, as I discuss next, are also implausible. I begin with complementary income.

B. COPYRIGHT OWNERS' PROPOSAL DEPENDS ON SPECULATION ABOUT COMPLEMENTARY INCOME (CROSS-SELLING)

72. Complementary income, as asserted by the Copyright Owners, is income that the Services purportedly earn in other, non-music businesses that is a direct result of music subscriptions. This additional income, the Copyright Owners' experts claim, must be included in the revenue base for royalties. But they do not show that music is actually *driving* income in other businesses. Apart from some isolated analyses of Amazon, the Copyright Owners' experts do little more than point to the fact the Services are diversified businesses and argue that a portion of the income from those businesses should be included in the revenue base for musical works royalties. They also fail to acknowledge the impact of those complementary businesses *on music subscriptions*. This is a crucial factor; it is easy to see why.

[106] Lundberg WDT ¶12.
[107] Segal WDT, ¶77.

73. Music streaming businesses (never mind the Copyright Owners) have little to do with the incremental music revenue created by the non-music businesses.[108] In other words, Copyright Owners' experts fail to consider that if the music streaming businesses were to claim a portion of the purportedly complementary income, the non-music businesses would also have a similar claim on the music streaming business. As a result, Copyright Owners' experts' justification of higher royalty rates based on the purported complementary income is fundamentally flawed.

74. *Second*, the Copyright Owners' experts also argue for the presence of complementary income by claiming that the Services are underpricing music subscriptions and could adopt a different business model. These claims are mistaken, too, as I explain below.

75. *Third*, the market behavior of the Services and Copyright Owners is inconsistent with complementary income being a significant factor. The interactive streaming Services offer their music subscriptions on other platforms, something a rational actor focused on complementary income would not do. In addition, Services and Publishers RESTRICTED [redacted]. Both of these pieces of evidence show that complementary income is not viewed by the parties in the real world as a meaningful factor and should not be taken into account under the WBWS standard.

76. Fourth, even setting aside all the problems described above, it still would not make sense for the Judges to factor complementary income into statutory rates because it would favor large, diversified companies over pure-play services. There are many pure-play services and setting rates high enough to account for such complementary income would likely make the pure plays unwilling buyers.

77. I discuss each of these points below.

[108] Consider, for example, the case of Echo and Amazon Music as standalone businesses. To the extent Amazon Music claims a share of purportedly complementary income that the music business generates for the Echo business, it is reasonable that the Echo business would have a similar claim on the complementary income that the Echo business generates for the music business.

1. The Copyright Owners Have Not Shown that Services Receive Complementary Income Driven by Music Or Accounted For Benefits Music Income Receives from Complementary Businesses

78. In the *Phono III* Determination, the Judges found, "…that there is no support for any sweeping inference that cross-selling has diminished the revenue base."[109] The Judges published the Final Determination in November 2018 when Apple, Amazon, and Google already had a diversified ecosystem. The mere existence of other businesses, in other words, did not convince the Judges that music streaming was driving revenues and profits in those businesses. Nevertheless, the Copyright Owners' experts do little more than cite the mere existence of these other businesses. They write at length about the size of the tech companies and their ecosystems, but, except for some limited discussion related to Amazon, do not quantify the amount of music streaming that is actually driving any of the growth in those business lines.[110] Nor do they even acknowledge, much less analyze, the extent to which the other businesses are driving music revenues.

79. Flynn, an expert witness for the Copyright Owners, for example, describes the Services as highly diversified, detailing their size, EBITDA and breadth of their businesses, but does not quantify the amount of complementary income that is actually being driven by music.[111] Flynn quotes executives' generic statements to the effect that music plays a strategic role in their ecosystems.[112] But statements like this do not address the crucial question of whether music is driving income in other lines of business, let alone take account of the benefit that other businesses might be providing to music revenues.[113]

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[109] *Phono III* Final Determination at 21.

[110] Flynn cites the RESTRICTED at ¶90 (COEX-8.116, part of Copyright Owners' WDS, Volume VI.G and Amazon Exhibit 20), discussed further below, as well as an eight year old document from Amazon at ¶¶98-99 and purports to calculate incremental revenues from Prime subscribers. But she makes no calculations for any other Services and fails to acknowledge that Amazon is in a unique position relative to the other Services and RESTRICTED [redacted] Duffet-Smith WDT ¶8. As I explain in the text, she does not take account of any impact that the complementary businesses of Amazon might have had on music subscriptions. Lastly, she presents no evidence or analysis for any other Service.

[111] *See* Flynn WDT ¶¶ 25-34, 65-101. Again, with the exception of Amazon data discussed above.

[112] For an example of this type of statement see Flynn WDT ¶77 ["Music plays a strategic role for building the Android ecosystem"]. She does not define 'ecosystem' in her report but apparently means it to include everything the Services offer. *See, e.g.*, Flynn WDT ¶65, where she says that "U.S. interactive music streaming revenues represent RESTRICTED of Amazon's, Apple's and Alaphabet's revenues in the aggregate."

[113] The same problems arise with Flynn's discussion of RESTRICTED. She cites this document in support of the claim that other Amazon businesses benefit from music subscriptions. Flynn WDT ¶90. RESTRICTED [redacted]

80. Eisenach uncritically adopts Flynn's numbers.[114] He presents only theoretical considerations of why it might be the case that the Services are underpricing streaming services.[115] Eisenach argues that "music is a central part of the customer engagement that drives these companies"[116] and calculates that the amount of time spent streaming music amounts to 6.5 hours each month per person in the U.S., asserting that this supposedly represents a substantial engagement with the ecosystems of the Services.[117] But he does not explain how mere listening to music is driving any other revenues and profits. Often people listening to music are just listening to music—*i.e.,* not engaging with the tech companies other services--or doing something else altogether, such as driving, studying, or exercising. Or else they *are* engaging with other of the tech companies' services—such as reading an Apple News story on their phone while listening to music—but this engagement is not being driven by the music itself.

81. Watt also does not provide any meaningful showing of how music is driving other revenues/profits. He argues that even 'tiny movements' in these other businesses as a result of music streaming will require changes to royalty rates, but apart from referencing the Amazon analysis done by Flynn, does not show that music causes *any* movements in any other specific businesses.[118,119]

82. None of the Copyright Owners' experts even acknowledges the flow of income from complementary businesses to music. It is likely that the very large ecosystems of the tech companies are driving subscribers *towards* music. It is critical to take this effect into account

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RESTRICTED

Mirchandani *Phono III* WRT ¶¶3, 7-19.

[114] Eisenach WDT ¶138. Eisenach cites Flynn as "provid[ing] another basis for assessing the magnitude of Amazon's complementary profits" and cites her for the proposition that Amazon's revenues from "complementary revenues and services" in the U.S. were $221.5 billion in 2020 and "more than RESTRICTED as much as it reported in declared revenue from its music streaming service."

[115] *See*, *e.g.*, Eisenach WDT ¶¶ 60-61. Eisenach merely describes the "customer lifetime value" and related concepts, as well as theoretical arguments about music being a complement but provides no actual analysis or evidence that they are complements in the important sense that music streaming is driving revenues in other business lines.

[116] Eisenach WDT ¶63.

[117] Eisenach WDT ¶63.

[118] Watt WDT, ¶6(vi).

[119] I note as well that Apple does not use data from music subscribers in any other of its businesses. *See* Apple's Response to First Set of Interrogatories #3, 11/18/21. "To the extent [Apple] collects data from Apple Music subscribers it does so for the purpose of creating taste profiles for its subscribers, so that it can provide them better listening experiences and more targeted music recommendations" or to "provide information to artists and music labels to help them understand the listeners of their music." In addition, "Apple does not use this data for purposes of promoting any products or services other than Apple Music (or the Apple One bundle, which contains Apple Music…Apple does not allow third parties to access information collected from Apple Music about individual Apple Music subscribers."

when assessing the impact of complementary businesses on the streaming business. The Copyright Owners do not even mention this possibility or model it in their Shapley analysis.

83. There is another aspect to the issue of complementary revenue that the Copyright Owners' experts do not acknowledge. The Services' hardware and other platforms drive revenue to Copyright Owners through royalty streams from sources other than interactive streaming. For example, the diversified companies in this proceeding create platforms that facilitate engagement with social media platforms, like TikTok and Facebook (that are used on, for example, iPhones) that pay music royalties to the Copyright Owners. They also have made it easier to watch television, engage with fitness apps, view audiovisual clips, and play games containing music, all of which increase royalties for Copyright Owners. In other words, Services have contributed to increases in Publisher and songwriter royalties not only through their interactive streaming services, but by making it easier for consumers to use other platforms that increase Publisher and songwriter royalties.

84. In short, the Copyright Owners' experts' assertion regarding the purported complementary income earned by the Services in their other non-music businesses are fundamentally flawed.

2. The Copyright Owners Have Not Shown that Services Underprice Music Subscriptions

85. Relatedly, the Copyright Owners' experts claim that the Services are using streaming as a "loss-leader"—that is, selling streaming at a price below its cost to garner benefits in other businesses.[120] This claim fails because, as noted above, the Copyright Owners' experts have not provided evidence that music drives revenues/profits in other lines of business in the first place.

86. Moreover, Spotify and Pandora Premium have generally been considered pure-plays in music and still sold streaming subscriptions at the same price of $9.99 as the other Services.[121]

[120] *See, e.g.*, Eisenach WDT at ¶¶ 61-62. I understand that there is an Amazon document stating that Amazon RESTRICTED Rysman Rebuttal *Phono* III Testimony ¶ 23 (emphasis added). The Copyright Owners suggest that this document proves that the services engage in loss leader strategies. My RESTRICTED *See* Mirchandani *Phono III* WRT ¶¶ 7-19. In any case, any concern about this issue can be addressed through the use of suitable minima centered around the standard price for a subscription service.

[121] *Phono III* Final Determination at 8.

This indicates selling at a price of $9.99 does not necessarily imply that the Services are underpricing their streaming services to drive complementary revenues. Even today, there are many streaming companies that are pure plays, though, of course much smaller, that sell at similar prices. *See* **Exhibit 5**.

87. This is not to suggest that the Services RESTRICTED Most are RESTRICTED

Growing subscribers to meet their fixed costs is demanding. Lowering their margins will make it even harder for them to grow sufficiently in subscribers to cover their fixed costs (*i.e.,* those costs that do not vary with revenue) as the industry is intensely competitive.[123]

88. Relatedly, Flynn argues that the Services are losing money because they are choosing a business model in which they offer a highly substitutable product. She writes:

> "Each of the Services offers access to materially the same library of songs, including the catalogs of all three major record labels and all of the larger independent labels as well. The Services do not appear to compete materially for exclusive music content. This is very different from how the Services approach other markets, and from how Apple, Amazon, Netflix and Hulu have approached the video streaming market, for example. If a firm is seeking to maximize profits from streaming products, the expected market strategy would involve seeking to license content exclusively. The Services use this business model in adjacent markets like VOD and podcasts. The video streaming services (including Apple and Amazon) allocate billions of dollars to obtaining exclusive content to drive subscriptions and reduce subscriber churn."[124]

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[122] **Apple**: "There is a popular misconception that RESTRICTED . But as this discussions (sic) shows, that is just not the case. Rather, RESTRICTED Segal Amended WDT at ¶59. **Amazon**: RESTRICTED ; **Pandora**: RESTRICTED White WDT ¶24 RESTRICTED ," Herring WDT ¶54. **Spotify**: RESTRICTED Kaefer WDT ¶49.

[123] Jeremy Bowman, "Music streaming is a Money Pit," Motley Fool [As the industry gets more competitive, the possibility of profits looks even more unlikely."] https://www.fool.com/investing/2016/09/18/music-streaming-is-a-money-pit.aspx (last accessed 4.5.22)

[124] Flynn WDT ¶123 [footnotes omitted].

89. Watt makes a similar claim.[125] They both argue, in other words, that the Services could make more money from music subscriptions by pursuing a different strategy, one modeled on the video or podcasting industry where they pay a premium to obtain exclusive content or offer limited catalogs from only one Label.

90. This is a puzzling criticism for numerous reasons. *First*, it's not clear how the strategy is to work—and none of the Copyright Owners' experts offer an explanation. The Services would need the catalogs of a Label as well as that of a Publisher, and hope that they overlap sufficiently so that they could offer songs for which they have both sound recording and musical works rights. Label and publisher catalogs need not contain rights to the same musical works and corresponding recordings. Presumably, there is an amount of money a streaming company could pay to a Label and a Publisher and obtain some set of exclusive songs, but it is not clear that consumers would buy a subscription for a partial set of catalogs or be willing to pay for multiple different streaming services.

91. *Second*, it is not clear that overall music revenues would increase under such an approach. For example, assume Apple signed an exclusive deal with Sony, Spotify signed an exclusive deal with Warner, and Amazon signed an exclusive deal with Universal. In order to gain access to the separate catalogs, consumers would have to sign with all three Services. And if the sum of the prices of the three subscriptions was greater than $9.99/month, and given the sensitivity of consumers to prices[126], overall revenues would likely decline.

92. *Third*, it is reasonable to expect that exclusive content would also increase service costs (resulting from the premium paid to acquire the exclusive content), which would further impact pricing and the feasibility of this approach. These and numerous similar questions would need to be analyzed in order to explain that an alternative model is feasible. The Copyright Owner experts do not analyze any of these issues.

93. Flynn complains that the Services approach the market differently from how, "Apple, Amazon, Netflix and Hulu have approached the video streaming market."[127] But video and podcasting are both very different: if a consumer watches a video, they watch for a substantial

[125] Watt WDT ¶61.
[126] *Phono III* Final Determination at 52.
[127] Flynn WDT ¶123.

period of time (say two hours for a movie) and then do not typically watch again. Music is consumed very differently—consumed for three or four minutes at a time and customers often create playlists of their favorite songs and artists to play again and again, building a library that will be expanded and played again over time. Video and podcasts are not consumed this way. If consumers were constrained to just a slice of the available music through one Service, it is possible that many current subscribers would not be interested at all in buying music subscriptions.

94. Also unexplained by the Copyright Owners' experts is, if adopting a new business model involving exclusive content would make the Services more profitable, why the Services are not already doing this. One possible explanation reported in the press are the many obstacles to exclusives in streaming music, including objections from the Labels and problems with piracy.[128]

95. In sum, the Copyright Owners' experts have not shown that the Services are underpricing their music subscriptions or that they could raise prices by adopting a different business model.

3. The Copyright Owners' claims about complementary income are inconsistent with market evidence

96. There are two important facts about the behavior of the licensors and licensees that the Copyright Owners' experts ignore. The first is the fact that interactive music streaming services each offer their music subscriptions on other platforms. Apple Music is available on Google Play,[129] smart TVS, such as Samsung TVs, PlayStation 5 consoles, and on Android.[130] Google Music was made available for iOS in 2013[131] and is still available today.[132] It is also available on Android.[133] Amazon Music is available on iOS[134] as well as Google Play.[135] Amazon is also available on Android, desktop apps, web-based, connected speakers, and in cars.[136] The tech companies would not do this as rational economic actors if they could gain significant

[128] *See, e.g.,* Con Raso, "How brands can capitalize on the end of streaming music exclusives," https://blog.tunedglobal.com/brands-capitalize-music-streaming-exclusives; Jacca-RouteNote, "The music industry fought against streaming exclusives, now Spotify and Apple Music are exploring them again," https://routenote.com/blog/streaming-exclusives-spotify-and-apple-exploring/.
[129] https://play.google.com/store/apps/details?id=com.apple.android.music&hl=en_US&gl=US.
[130] https://support.apple.com/en-us/HT210412.
[131] https://www.cnet.com/reviews/google-play-music-ios-review/.
[132] https://www.appstoreapps.com/app/google-play-music/.
[133] https://www.androidauthority.com/how-to-use-google-play-music-845165/.
[134] https://apps.apple.com/us/app/amazon-music-songs-podcasts/id510855668.
[135] https://play.google.com/store/apps/details?id=com.amazon mp3&hl=en_US&gl=US.
[136] https://www.whathifi.com/us/best-buys/streaming/best-music-streaming-services.

complementary income in other business lines—they would be incentivized to keep their services exclusive to their platforms. Apple's witness [redacted][138]

97. The second fact the Copyright Owners' experts ignore is that complementary income [redacted] that Services, Copyright Owners and Labels have negotiated in the marketplace. Apple, for example, has entered into a variety [redacted]

98. The evidence does not support an inference that complementary income has played a meaningful role in the market-based agreements between Apple and licensors or in the business practices of the tech companies.

4. Even if Complementary Income Could be Shown to be Significant, Incorporating it into Royalty Rates Would Likely Violate the WBWS Standard

99. As I explain in *Section IV.C*, under the Copyright Owners' theory, even if there was complementary income, it would (implausibly) have to be something the Labels could not even guess or else they estimate it and extract it during their negotiations with the Services. Even if one could somehow set aside all of the problems described in more detail above, and could somehow show (again, implausibly), that there was complementary income after adjusting for any other effects that benefit music, there would still be another problem with the Copyright Owners' theory: incorporating complementary income into higher royalty rates would likely

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[137] Segal Amended WDT ¶62 ["…Apple Music does not engage in revenue deferral or a loss leader approach…"]
[138] Levine *Phono III* WRT ¶¶8-9 ["These claims about Google are unequivocally unfounded. To assert that Google plans to use Google Play Music, a service with [redacted] in the U.S., to "gro[w] [its] base of customers to whom [it] can then market [its] other products and services" is absurd on its face. It is public knowledge that Google's other products already reach literally hundreds of millions of people in the U.S. The idea that Google is intentionally driving down the price of Google Play Music in order to "grow a base of customers" who will then be more likely to use Search or GMail or Google Maps simply strains credulity. The value proposition flows in the opposite direction. Google Play Music is marketed to a far wider net of possible subscribers because of Google's brand and the reach of Google's other products. Google's addressable market for Google Play Music is greatly enhanced by the massive market penetration of Google's other products and services."]; Amazon, Hurwitz WDS ¶ 19-20, 28. [footnotes omitted]
[139] **Exhibit 2**.

violate the WBWS standard. This is because factoring purported complementary income into the rate calculation would likely drive out all but the wealthiest streaming companies as companies without this complementary income would be unable to afford to participate. These higher rates, therefore, would be unlikely to meet the WBWS standard.

100. In sum, the Copyright Owners' experts claims about complementary income are speculative and implausible.

C. COPYRIGHT OWNERS EXPERTS' INCORRECTLY CLAIM THAT ASYMMETRIC INFORMATION JUSTIFIES HIGHER STATUTORY RATES

101. I turn now to another problem with the claims the Copyright Owners' experts make with respect to complementary income. Even if they could show that the complementary revenues/profits exist, they would also need to show, under their theory, that the Labels made no allowance for this complementary revenue in their negotiations. This is implausible.

102. The Copyright Owners' experts argue that the Services have *asymmetric information*. What they mean by the use of this term is that there is complementary income available to the Services that arises from their complementary businesses, but their other businesses are so opaque that it is impossible for anyone else (including the Labels) to see this hidden complementary income, or *even to surmise* that it exists. Of course, they do not describe it this way (that it cannot even be guessed at) because even to state it is to state the implausible. According to Eisenach:

> "the complexity, opacity and fluidity of the Platforms' business models has created an information imbalance in favor the Platforms. As Professor Michael Katz, a witness for Pandora in *Phonorecords III* explained it, 'bargaining with the services under asymmetric information' means that 'there are things that services know about themselves and their level of surplus that the record companies don't know. So I don't think the record companies – certainly, for services that are owned by large parents that don't break out all of their results in detail, they won't have the ability to determine exactly what the surplus [complementary income] is of the services.' This is precisely the sort of information asymmetry which, as I explained above, results in one party

> extracting more from a bargain than is justified by its economic contribution."[140]

103. Watt uses different terminology: instead of complementary income, he refers to *parallel or displaced income*:

> "In past proceedings on the issue of setting the regulated rate for musical works copyright licensing, much has been made of the 'see-saw' effect – the idea that an increase in the statutory rate for musical works will not have an undue effect upon the economic situation of services, since if the record companies have been capturing a large portion of the surplus in their negotiations with the services, then much of the increase will be counter-acted by a decrease in the bargained rate for licensing of the sound recording copyright. Since the labels do indeed bargain with services for their licensing rate, and they do that with knowledge of the statutory rate that has been set, the see-saw effect is persuasive and it will exist. However, it is worth analysing particularly how this dynamic is affected by parallel (or displaced) income earned by the services due to the operation of interactive streaming, but that was not included in the revenue sharing pool. As it happens, this parallel income is fundamental in considering the see-saw, and indeed in considering the relevant level of the statutory rate."[141]

104. Parallel or displaced income 'that was not included in the revenue sharing pool' during negotiations is the same as 'complementary income that is hidden to the Labels.' The Labels, for this to be true, under the Copyright Owners' theory, have to have no idea that this additional income exists. If, hypothetically, this complementary income existed and the Labels knew of its existence, they would make an estimate of the amount (or make an allowance for it in their negotiations) and, according to the Copyright Owners' experts' theory, *extract* it. It is implausible, though, to believe the Labels, with all the resources at their disposal and over the course of relationships with the Services stretching back over a decade, cannot see what the Copyright Owners experts claim to so easily be able to see and identify this complementary income. Hence, even if there was complementary income, one would need to also know what *estimate* the Labels made of this complementary revenue—or what allowance was made for complementary income in the negotiations. The Copyright Owners' experts do not acknowledge this point. .

105. There is always some measure of information asymmetry in any negotiation. For example, the Copyright Owners have superior access to information about the quality of the

[140] Eisenach WDT ¶66. [fn omitted]
[141] Watt WDT ¶221 [emphasis added].

musical works catalogs they are licensing, their costs, and other features related to their business. The Labels have superior information about these factors as well. And parties do not typically share all of the ancillary benefits they might receive from a deal with their negotiating partners.

106. The Copyright Owners' experts have not shown that any meaningful information asymmetry about complementary income has played a role in the negotiations between the Services and Labels or would in the future. Their claims about asymmetric information and complementary income are implausible.

V. THE COPYRIGHT OWNERS' PROPOSAL DEPENDS ON A 2.5:1 RATIO THAT IS BASED ON AN INHERENTLY SPECULATIVE MODEL, IS NOT REASONABLE AND DOES NOT LEAD TO RATES THAT REFLECT THE WBWS STANDARD

107. In order to arrive at his proposed rate levels, Eisenach relies upon a ratio of 2.5 to 1, representing the ratio of sound recording royalties to publisher royalties. He uses this ratio, for example, to adjust various terms in Service-Label agreements to arrive at proposed terms for royalties between Services and Publishers, as described below. I have already discussed some of the reasons why the use of this ratio (or any ratio of sound recording royalties to publisher royalties, *see Section VI.A*, which discusses the See-Saw theory) is unwarranted to begin with. But there are numerous other problems with this ratio.

108. *First*, Eisenach claims to obtain this 2.5 to 1 ratio from the *Phono III* Determination[142]—but the *Phono III* Determination actually begins with this ratio but then adjusts for the market power of the Labels[143] and arrives at a ratio of 3.82 to 1. The Copyright Owner's experts, on the other hand, make no adjustment for the market power of the Labels. So their use of this ratio is not, as they claim, grounded in the *Phono III* Determination. *Second*, one of the principal justifications the Copyright Owners' experts offer for this ratio is a theoretical modeling exercise that produces lower ratios but which, I explain below, is arbitrary, flawed, divorced from reality and produces unreasonable results. *Third*, [redacted] *Fourth*, the agreements that Eisenach does offer in support of a 2.5 to 1 ratio (or lower) are not comparable—including non-comparable audio-visual

[142] Eisenach WDT ¶84 and fn 73.
[143] *Phono III* Final Determination at 72-74 where 72.9% divided by 15.1% equals 4.82 (the sum of 3:82 and 1. *See also* December 9, 2021 Order at 1-4.

agreements and Label agreement terms adjusted by this ratio—and hence do not support this 2.5 to 1 ratio, either.

A. WATT'S SHAPLEY MODEL RESULTS DO NOT JUSTIFY ADOPTION OF A 2.5:1 RATIO (OR ANY OTHER RATIO)

109. Watt presents a Shapley model to argue that even the RESTRICTED is too high.[144] But as I explain below, the model is flawed in numerous ways.

1. Shapley Modeling Depends on Modeling Assumptions and Does Not Produce a Market-based Result

110. Watt makes a set of simplifying assumptions. He reduces the dozens and dozens of players in the real world to a handful,[145] identifies a few parameters he thinks capture something important about the real world and then runs a series of different orderings of 'arrivals' and assesses the average marginal contribution of each arriving player to the surplus. The Shapley modeling done by Watt depends crucially on how these parameters are defined, whether important parameters are missing from the model, and whether there is appropriate evidence justifying how the parameters are calibrated. If, as here, the set of assumptions is obviously incomplete, if the assumptions can range in arbitrary ways untethered to any evidence or reality, and the results obviously conflict with known market-based results, the model, in this matter, does not produce results reflecting an effectively competitive outcome consisttent with a WBWS standard.

111. Watt admits that Shapley modeling itself depends on the choice of assumptions used to construct the model. Watt introduces his Shapley analyses as a series of 'modeling choices' that need to be made.[146] "These choices seek to distil[sic] and represent important features of the market," he writes.[147] He identifies the inputs he will use and then "run the model using different combinations of choices to show the results under such different choices, also providing a

[144] Watt WDT ¶141.
[145] Watt WDT ¶¶ 50, 53, 54 ["The market has many music publishers and self-published songwriters, far too many to model each separately." ¶50; "The interactive streaming market in the U.S. has many active services but the market is dominated by four" ¶53; "The market has many record companies, far too many to model each separately…" ¶54].
[146] Watt WDT ¶46.
[147] Watt WDT ¶46.

sensitivity analysis."[148] Already we see that Watt is acknowledging what every modeler knows: that the model is only as good as its inputs. If important real world elements are left out, the model will not reflect reality. If the inputs to a model are set at arbitrary levels not calibrated to reflect reality, neither will the results.

2. Watt Leaves Out Important Inputs

112. Watt identifies a set of inputs he will vary: players, substitutability and necessity, displaced income, and costs.[149] The first is which players to include in the model. He settles on Publishers, Services and Labels.[150] Recognizing that he must trade off real world complexity to accommodate the model, he writes that "The market has many music [P]ublishers and self-published songwriters, far too many to model each separately."[151] He decides to vary the input from one to three Publishers.[152] For the Services, he varies the input from one to four Services.[153] And for the record companies, he models from one to four record companies.[154] His 'preferred' model is one containing three Publishers, three Labels and three Services.[155]

113. Next, he models 'substitutability and necessity.' He concludes that the Services are highly substitutable with little market power (though he does include one scenario with a single Service).[156] The Publishers and Labels, on the other hand, have a low substitutability in Watt's model.[157] He uses a scale from 0 to 1, with 0 indicating perfect substitutability, and 1 indicating there are no substitutes. He assigns a value to the Services parameter of 0.1 (indicating relatively high substitutability) and 0.9 to Publishers, indicating low substitutability.[158] He uses a variable k to indicate whether record company catalogues are strictly necessary (must-haves): if k equals 1, all the record company catalogues must be present for there to be positive revenue from the coalition of players); if k equals 0, then revenues can be generated even if all the Labels are not present.[159]

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[148] Watt WDT ¶46.
[149] Watt WDT Section VII.
[150] Watt WDT ¶¶47-54.
[151] Watt WDT ¶50.
[152] Watt WDT ¶50.
[153] Watt WDT ¶53.
[154] Watt WDT ¶54.
[155] Watt WDT ¶52.
[156] Watt WDT ¶¶55-57.
[157] Watt WDT ¶¶58-59.
[158] Watt WDT ¶133.
[159] Watt WDT ¶¶117(f), 113.

114. Next, he models revenues depending on the different cohorts of players that are possible. He adds a new parameter to his model to account for what he calls 'displaced income.'[160] This refers to income that is "not currently shared with copyright holders."[161] This is the hidden complementary income discussed above, which supposedly derives from the complementary businesses of the Services, but which the Copyright Owners have not shown actually exists across the Services. It arises, according to Watt, due to 'asymmetric information.'[162] Watt models this displaced income—making arbitrary assumptions about its magnitude, resulting in scenarios under which the Services paying out more than 100% of all music subscription revenues. According to Watt:

> Including a best estimate of parallel net revenue in the calculation of the total revenue that derives from interactive music streaming is more appropriate, and as shown below, the result of such an estimate is to deliver the Copyright Owners a higher participation in that fraction of total revenue that is actually counted within the "shareable pool."[163]

115. Next Watt models costs. For the Labels and the Publishers, costs represent their contribution to the Shapley surplus.[164]

116. What Watt leaves out is noteworthy. He does not model any complementary income flows *from* other businesses *towards* music. He does not model *any* complementary income flows generated by platforms that the tech companies created and by which the Copyright Owners are receiving royalties from services like TikTok. He makes *no* allowance for any estimates that the Labels would make of this supposed complementary income (which under his theory they would extract during negotiations with the Services). He makes *no* allowance for the structural forces present in agreements between the Services and the Labels and between the Services and Publishers that entail RESTRICTED and cannot adjust in the way the See-Saw theory relies upon. And he makes no allowance for real world agreements with the Labels, which RESTRICTED, as noted above, which would make the See-Saw effect even less likely.

[160] Watt WDT ¶117(c).
[161] Watt WDT ¶71.
[162] Watt WDT ¶¶74-75.
[163] Watt WDT ¶75.
[164] Watt WDT ¶¶91-112.

3. Watt's Inputs are Not Calibrated to Reality

117. Another problem with Watt's analysis is that for the inputs he does include, he does not use any market evidence to calibrate them, relying instead on his judgment. For example, he uses values for substitutability of 0.1 and 0.9 in his preferred model. He has arrived at these numbers purely through his understanding of the relative value of the market power of the Services, the Publishers and the Labels.[165] He makes little to no attempt to calibrate them to reality. For his complementary income parameter, q, he also has no basis for his assumption that 'hidden income' across the Services could be 0%,10%, 20%, or 30% higher than actual subscription revenues (in his preferred model reflected in Table 5). He writes that

> Sweeping the issue under the carpet, or excluding parallel income from consideration because it is hard to calculate precisely, is a particularly inappropriate choice when the rate standard provides for a rate that represents the contributions of the different players to *all* of the surplus that is created from interactive streaming of music.[166]

118. But it would appear that this parallel income is not just "hard to calculate precisely." Watt in fact makes no attempt to calculate it. He just decides that it might be 0%, 10%, 20% or 30% of Services' subscription revenues in his preferred model.[167]

119. Ultimately, what he offers in his report are a set of incomplete inputs untethered to reality and in many critical respects founded on nothing more than his say-so. He invites the reader to follow him as he changes different values of his limited set of inputs to show what he purports to be a reasonable range of sensitivity analyses. They are not reasonable at all, as I discuss next.

4. Watt's Model Produces Arbitrary and Unreasonable Results

120. Watt varies these different inputs (players, substitutability and necessity, revenues and costs) and ultimately generates a series of ratios of sound recording to publisher royalties that are significantly below 2.5 to 1.[168] In his 'preferred model' he calculates that Copyright Owners should get between **33%** and **50.5%** of revenues.[169] This represents an increase of **214%** to

[165] Watt WDT at ¶¶46-77.
[166] Watt WDT ¶75.
[167] Watt WDT Table 5. These percentages correspond to q values of 0, 0.1, 0.2 and 0.3 respectively. Later in the Watt WDT, he picks up on Flynn's analysis of Amazon discussed above and shows an even higher q value of 0.36. Watt WDT ¶¶152-156. But as I have noted in the text, he makes no attempt to estimate the benefit that music might have received from Amazon's non-music businesses, makes no attempt at any calculations for any other Services, and makes no allowance for what estimate the Labels would make about the complementary income.
[168] Watt WDT ¶150.
[169] Watt WDT Table 5.

381% in Copyright Owner royalties over the Phono II rate of 10.5%. The Services in his preferred model would pay out between [redacted] and [redacted] of revenues in royalties.[170] That is, at the upper end, the Services would pay out more in royalties than they collect in music subscription revenues. This is justified, under Watt's reasoning, because they have hidden income that he can see but the Labels know nothing about. But that is not all. He varies the amount of this hidden income by the following (arbitrary) amounts: 0%, 10%, 20% and 30%.[171] What is the basis for these amounts? There is none, apart from a reference to the limited Amazon analysis that Flynn did. He has no basis to assume any level of complementary income that would apply across the Services. Watt believes he has only to show that even "tiny" amounts of displaced income will lead to the Services paying out more than they take in:

> The size of the complementary product markets of the three technology firms that make up the majority of the streaming market are so large by comparison to the streaming market, that **even tiny movements in those markets** as a result of the music delivered by the joint venture deliver sharing rules that allocate more than 100% of streaming product revenues to copyright owners. Such sharing rules are effectively delivering the result as if the information asymmetry was lifted, in other words, as if copyright owners knew what Amazon, Apple and Google know about the effect of music on their ecosystem.[172]

121. In Watt's model, the hidden income can be 0%, 10%, 20%, 30% or somewhere in between. His model can literally come up with any amount of royalties for the Copyright Owners with a suitably large q value, up to the value of all the tech companies revenues/income. Watt *himself* previously (in *Phono III*) concluded that total royalties (to Publishers and Labels) should, under his then-Shapley analysis, range from 64% to 70%, with a midpoint of 67%.[173] This means that he previously concluded with his then-Shapley analysis that the Labels would permit the Services to keep 33% of subscription revenues, writing:

> Overall, it would appear that a conservative value (near the middle of the range of assumptions) for the total copyright fee as a fraction of total downstream revenue is about 67% (out of a range that is between 64% and 70% of streaming revenues for royalties).[174]

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[170] Watt WDT Table 5.
[171] Watt WDT Table 5. These percentages correspond to q values of 0.1, 0.2 and 0.3, respectively.
[172] Watt WDT ¶6(vi) (emphasis added).
[173] Watt *Phono III* WRT Table 1and ¶34.
[174] Watt *Phono III* WRT ¶34.

122. Under his new-Shapley analysis, he has decided differently: the Services should pay at least 78% and perhaps as much as 112.8% or more of their revenues.[175] The primary driving force behind this broad range is the arbitrary assumption about the magnitude of hidden complementary income. If hidden complementary income is zero, the Services in Watt's model should pay total royalties of 78%. If hidden complementary income is 30%, the Services should pay 112.8%.

123. Watt's model is speculative and arbitrary, untethered to reality, and produces a wide range of results based on a parameter (complementary income) that, as I have explained, has not been shown to exist, does not account for complementary effects towards music and is part of an implausible theory about asymmetric information. Watt's model cannot be relied upon.

124. There is reason to doubt that any Shapley model, for this matter, can produce an effectively competitive result. Shapley models assume the presence of all the relevant players, who jointly contribute to creating surplus value. But in the real world, the Labels are not present and are not subject to oversight by the CRB or otherwise. Shapley modeling therefore will not reflect this simple fact and will instead impose an arbitrary and unrealistic framework assuming that all the players will arrive at the same time to create the joint surplus. Shapley modeling should not be expected to produce an effectively competitive result.

125. In addition, Watt's Shapley results are directly contradicted by RESTRICTED [redacted], and with the settlement reached in 2021 under the WBWS standard related to physical sales and PDDs. These RESTRICTED [redacted] I turn to this evidence next.

B. MARKET EVIDENCE INDICATES THAT THIS 2.5 TO 1 RATIO IS WRONG

1. The Ratio Derived from Physical Phonorecords and PDDs is Significantly Higher than 2.5 to 1

126. As I noted in the Prowse WDT, the rate of royalties for physical phonorecords and PDDs was agreed to by the Services and the Copyright Owners in 2008 to be the greater of 9.1 cents per song or 1.75 cents/minute, or fraction thereof, of playing time.[176] In 2012 the parties reached

[175] Watt WDT Table 5.
[176] Prowse WDT ¶188.

a second settlement and then again in 2016, the parties reached a third settlement, each time with the same rates.[177] In 2021 there was a new WBWS standard and several of the licensors and licensees again settled for the same rates.[178]

127. At the same time,[179] the Services offering downloads were paying the Labels who paid royalties to Copyright Owners. Hence it is possible to derive a ratio representing the sound recording royalties to the musical works royalties for downloads. Under RESTRICTED [redacted].[180] The RESTRICTED [redacted] Therefore, if a Label received RESTRICTED [redacted] for a download and paid the publisher RESTRICTED [redacted] it would have received RESTRICTED [redacted] cents. The ratio of the sound recording royalties to publisher royalties would therefore be RESTRICTED [redacted] Using the RESTRICTED [redacted] The range of ratios produced by these agreements is RESTRICTED [redacted] than 2.5 to 1.[181]

128. Physical phonorecords and PDDs, furthermore, are also significantly more relevant than the benchmarks Eisenach uses, which I discus below, many of which relate to audiovisual works. PDDs involve the same parties as this proceeding (Publishers, Labels, and music Services) for the same type of product (songs without video).

2. The Ratio Derived from RESTRICTED [redacted]

129. RESTRICTED [redacted] for interactive streaming provide additional market-based datapoints. These agreements also show that a ratio of RESTRICTED [redacted].

[177] Prowse WDT ¶¶189-190.
[178] Prowse WDT, ¶¶191-194.
[179] The Amendment RESTRICTED [redacted]. Exhibit 186 (APL_PHONO_00004529 – 639) (Exhibit B at p. 43 has the rates); Apple's Amendment with UMG was dated 12/23/08 Exhibit 187 (APL_PHONO_00004814 – 844) (Exhibit C-1 at p. 1 has the rates); Apple's Amendment with Warner was dated 12/19/08. Exhibit 189 (APL_PHONO_00005334 – 345) (rates are on p. 4).
[180] Rebuttal Testimony of Elena Segal WDT ¶151.
[181] I understand that the CRB recently ruled that the royalties paid to Publishers of 9.1 cents was too low as it had remained the same since 2006. This ruling does not change the opinions I express in my WRT for two reasons. Firstly, the Publishers agreed to these rates, indicating they were willing sellers, so this is a relevant data point to consider under a WBWS standard. Secondly, the ratios produced are so high that the royalty rate paid to Publishers could have been significantly higher and still could have resulted in a ratio significantly above 2.5 to 1.

130. In its direct deals with Publishers, RESTRICTED [182] Under these agreements, RESTRICTED . Further, RESTRICTED the ratio is even higher. For example, in 2020, when RESTRICTED

131. Similarly, the agreements that Apple has negotiated directly with PROs, RESTRICTED . The PRO agreements reflect an overall share of performance rights of RESTRICTED, which is half of the overall rate of RESTRICTED, reflecting the fact that each of these rights are perfect complements. These agreements therefore provide additional market evidence for the RESTRICTED headline rate in Apple's agreements with Publishers. This is true of the ASCAP Agreement[185]; the GMR Agreement;[186] and the BMI Agreement.[187]

132. Furthermore, if we look at actual payments, in 2021, RESTRICTED for

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[182] RESTRICTED (These last three agreements and related amendments are identified in Prowse WDT Exhibit 7).

[183] APL-PHONO4_000000472.

[184] APL-PHONO4_00008386.

[185] RESTRICTED APL-PHONO4_00008651.

[186] RESTRICTED

[187] BMI, APL-PHONO4_00009519, Definition for "Percentage Share" meaning 3.1%, reflecting the same considerations as the ASCAP agreement above.

performance royalties.[188] Assuming equal value for performance and mechanical rights, that is a ratio of RESTRICTED all-in.

133. As was true of the rates for physical phonorecords and PDDs discussed above, these agreements directly involved the relevant licensors (the Publishers) and the same type of product (music audio with no accompanying video).

C. THE BENCHMARKS OFFERED BY COPYRIGHT OWNERS' EXPERTS ARE NOT COMPARABLE

134. Eisenach presents data on three different types of agreements that he claims are relevant benchmarks: Label Interactive Deals (between Services and Labels); audio-visual blanket licenses; and RESTRICTED after the *Phono III* Determination. None of these agreements are appropriate benchmarks.

1. Eisenach's Label-Service Agreements Are Not 'Market-based'

135. Eisenach relies on Label deals for three aspects of the Copyright Owners' rate proposal. First, he uses Label agreements to attempt to show that the inclusion of a per-play rate along with multiple other prongs is becoming more common.[189] As I explain, this is not true. Second, he attempts to use Label agreements as evidence for what publisher royalty rates should be. He takes rates from Label agreements and simply divides those numbers by his preferred ratio of 2.5 to 1.[190] This, as I explain below, is a flawed exercise. And third, he uses two of Apple's agreements to attempt to show that RESTRICTED [191] Here, too, he is mistaken.

136. In the past, the Judges have rejected the validity of these Label agreements as a benchmark for musical works rates due to the major Labels' "complementary oligopoly" power.[192] In my WDT, I explained how the TCC prong imports that market power into musical works rates hence violating the WBWS standard from an economic perspective.[193] However, I

[188] This is based on the first 10 months of data, as shown APL-PHONO4_00008386.
[189] Eisenach WDT ¶72.
[190] Eisenach WDT ¶¶81-84.
[191] Eisenach WDT ¶89.
[192] "The Judges explained at length in *Web IV* how the complementary oligopoly nature of the sound recording market compromises the value of rates set therein as useful benchmarks for an 'effectively competitive' market." *Phono III* Final Determination at 47.
[193] *See generally* Prowse WDT, Section V.B.

also explained that the record Labels' acceptance of certain terms would indicate that those terms promote their economic interests and are, therefore, likely to do the same for similarly situated Copyright Owners.[194]

137. So I do not reject out of hand the relevance of whether Label agreements contain certain structural elements, such as a per-play rate, to the extent they are used to show that such a structure is beneficial *to a copyright owner*. The inclusion of a particular rate term in a Label agreement, however, does not necessarily mean that term is something *a Service* would agree to absent Label market power.

[redacted].[195]

RESTRICTED

[redacted]

139. The Copyright Owners' experts ignore all of these common Label agreement terms in their analyses.

[194] Prowse WDT, fn. 258. *See also* Segal WDT at ¶¶ 134, 137.
[195] *See* Prowse WDT, Exhibit 7 and the listed agreements. *See also* APL-PHONO4_00009631 at 9638, 9685.
[196] Apple Amended WDS Volume I at 1.

(a) Label Agreements do not show that per play rates in combination with other prongs are becoming common across the interactive streaming industry

140. The evidence Eisenach presents does not show that PPRs are becoming increasingly common and he has not shown there are any agreements that have all four prongs that the Copyright Owners propose. Instead, the majority of the agreements he cites are for only a narrow type of service or situation:[197]

141. Eisenach also cites agreements between RESTRICTED PPRs make more sense when tied to ad-supported services because revenue is tied to consumption. RESTRICTED

142. Similarly, RESTRICTED [199]

143. Eisenach, has not, in other words, presented evidence of RESTRICTED of PPRs for overall interactive streaming offerings, and especially not the use of PPRs alongside the three other prongs (in a maximum-of-the-prongs formulation) as the Copyright Owners propose. I understand that Apple has advocated for a PPR in the past, and there may be logic to adopting a fixed value for a stream but combining a PPR with several other prongs does not appear to be

[197] Eisenach WDT ¶92 and COEX-7.30.
[198] Meaning there is a clause in the agreement saying that the level of the PPR is not to be relied upon in setting future rates. COEX-7.74 at 9 to the CO's direct testimony.
[199] APL-PHONO4_00001700, APL-PHONO4_00001680.

(b) The rate levels in the Label Interactive deals cannot be considered benchmarks for publisher royalties

144. The Label Interactive deals Eisenach cites do not establish a benchmark for the rate level in this proceeding. As an initial matter, it is important to remember that Label agreements are (a) not for the same rights at issue in this proceeding, and (b) do not involve the owner of the right that is relevant in this proceeding. Therefore, they are a far inferior benchmark as compared to (i) the *Phono II* Settlement, (ii) Apple's direct deals with Publishers for the specific rights at issue in this proceeding and (iii) PRO deals, which involve a perfectly complementary right to the mechanical right that, like the mechanical right, is owned by the Publishers and songwriters.

145. Eisenach seems to implicitly recognize that Label deals are an imperfect benchmark, as they require a significant adjustment. Eisenach applies a *ratio* (the same 2.5 to 1 ratio discussed above) to Label deals to arrive at proposed rates. This Board has, of course, relied on ratios and benchmark adjustments in the past to arrive at rate levels when a benchmark is imperfect, but doing so makes little sense when there are directly negotiated agreements and settlements for the specific rights at issue between the parties to this proceeding. This is all the more true when, as I showed above, the ratios from the directly negotiated agreements and settlements show ratios RESTR [redacted] Eisenach uses.

146. Specifically, Eisenach claims that the Interactive Label agreements provide evidence of the appropriate revenue percentage and the PSM. He lists the various agreements in his Table 3 and then, starting with the sound recording royalty amounts for revenues and PSMs, merely applies his 2.5 to 1 ratio to calculate the "Implied Musical Works" and "Implied Mechanical Only" PSMs.[200] After doing this calculation for the revenue prong, he writes:

> As the table shows, the percentage of revenue rates in these agreements ranges from RESTRICTED. Adjusting these benchmarks using the 2.5:1 valuation ratio results in benchmarked musical works rates ranging RESTRICTED [redacted][201]

[200] For the PSM, he makes an estimate for the amount of PRO royalties, so it is not a direct 2.5 to 1 ratio (Eisenach WDT ¶88).
[201] Eisenach WDT ¶86.

147. In other words, he has taken sound recording royalty rates, which incorporate unregulated market power and simply applied the 2.5 to 1 ratio. In *Phono III*, the Board adjusted this 2.5 to 1 ratio to account for the market power of the Labels.[202] That is one reason his adjustment is not reasonable. But another reason Eisenach's rates cannot be considered to be accurate market based benchmark rates for Publisher royalties when *actual, market-based agreements with Publishers show rates* RESTRICTED The same is true of his calculations for PSMs.

148. This leads to another problem. The PSM in the Copyright Owners' proposal is derived from RESTRICTED applying the flawed (*see Section V.A*) 2.5 to 1 ratio to the RESTRICTED . It is therefore not appropriate to simply divide the RESTRICTED by 2.5 and use that number in a rate structure that does not provide RESTRICTED

149. Eisenach applies the same general formula to the levels of PPRs - taking a Label number and then adjusting it with his same, flawed ratio of 2.5 to 1.[203] But here he is mistaken for two additional reasons. First, he ignores PPRs for ad-supported services. While he found that RESTRICTED , he concludes that PPRs for ad-supported services "RESTRICTED "[204] Had he used those rates, his calculation of the appropriate PPR would have been RESTRICTED than in the Copyright Owners' proposal.[205] He refuses to include PPRs for ad-supported services in his analyses *even though the Copyright Owners' proposed PPR applies to ad-supported services*. This makes no sense.

[202] *Phono III* Determination at 73-74.
[203] Eisenach WDT ¶94.
[204] Eisenach WDT ¶93.
[205] Eisenach has produced a table in his backup files RESTRICTED . *See* "05 Table 3 and ¶¶86-88, 92, 94-95.xlsx." *See also* Eisenach WDT ¶94.

(c) [redacted] Are Not Comparable

150. Eisenach argues that [redacted] "further reflect the steady strengthening of alternative prongs in market deals."[206] He seems to be pointing to these agreements as justification for adopting a PSM that is not aligned with the headline rate. These agreements do not provide this justification.

151. Traditionally, the PSM for a standard subscription service was equivalent to the headline percentage of revenue applied to the standard retail price. For example, under *Phono II*, the headline rate is 10.5%. When applied to the standard subscription price of $9.99, that is the resulting $1.05 per user, split 50/50 between mechanical and performance royalties leads to a roughly 50 cent PSM. [redacted][207] But this is not, as Eisenach argues, a sign that PSM are strengthening in general. Rather, [redacted]"

2. Audio-visual streaming license rates are not comparable

152. In addition to Label agreements, Eisenach points to audio-visual licenses as benchmarks to support the Copyright Owners' rate proposal.[209] Specifically, the Copyright Owners' experts claim that the Publishers' blanket licenses for audiovisual works support the reasonableness of the 2.5:1 ratio because (a) [redacted] than 2.5:1.[210] He recognizes that the CRB has previously found that the use of a sound recording and musical work in an audio-visual production entails very different bargaining

[206] Eisenach WDT ¶¶89-90.
[207] [redacted]
[208] [redacted]
[209] Eisenach WDT at ¶108.
[210] Eisenach WDT ¶¶109-110.

power on the part of the licensor compared to interactive streaming.[211] This is because a buyer of a synchronization license (a license to synchronize a musical work with an audiovisual work), unlike a streaming service, often need not provide the exact recording that a consumer requests: given all the other creative inputs in an audio-visual recording, it can substitute a different sound recording of the same song. This stands in stark contrast to interactive Services: they must have the exact sound recording their streaming customers want, usually recorded by the artist who made it famous. As a result, the label licensors (the owners of the sound recording, which may be substitutable) have much less bargaining power when it comes to synchronization licenses than do publishing licensors (the owners of the composition, which is not substitutable).

153. I understand that Labels do not typically co-own sound recordings with other Labels. Therefore, a licensee can license from only a single record Label and be certain that it has the rights to the sound recording. If, as is the case with audio-visual services (as explained below), the service does not need to have all the Labels' catalogs, the Labels will have relatively less bargaining power than they do in relation to the interactive streaming companies. When negotiating with Publishers, on the other hand, the audio-visual service will have less bargaining power because multiple Publishers may own rights in a musical work--a license from a single publisher may not be sufficient. Audio-visual licensees can also bypass Labels' catalogs by creating new covers of songs for use in connection with audiovisual works, eliminating the need for a sound recording license entirely. They cannot bypass publishers' catalogs in this way.

154. Despite the Board's prior statements regarding audiovisual licenses, Eisenach argues that *blanket* licenses for the use of sound recordings and musical works in connection with services providing audiovisual content are relevant benchmarks. Blanket license agreements, he argues, are voluntarily agreed to and:

> involve digital music platforms which seek blanket licenses in order to allow their users to select from within the entire catalog, just as do Spotify and other interactive streaming services. From an economic perspective, the fact that the use case is different (including that it incorporates an audio-visual component) may impact the total value of the bargain, but there is no reason to believe that it would affect the *relative* value of sound recording rights and musical work rights, which

[211] Eisenach WDT ¶107.

> are perfect complements to these services just as they are in the case of interactive services.[212]

He is mistaken. First, Publisher licensors of audiovisual licenses still have substantially more bargaining power in relation to Label licensors than they do in the case of interactive streaming. Second, even with blanket licenses for creating audiovisual works, the relative value of the musical work to the sound recording is skewed in favor of musical works. It is easy to see why.

155. When a movie producer, for example, wants a song to synchronize with a scene, she is not bound to any particular recording: there are many substitutes. This does not change if that movie producer is required to buy a blanket license for a Label's catalog. The catalogs of *other* Labels will do equally well in most cases. Any particular Label's catalog, in other words, is not a 'must-have.' By contrast, because, as I note above, Publishers often co-own musical works, Publisher catalogs are much closer to must haves. In addition, the producer could forgo the sound recording rights entirely by creating a cover song. This scenario is different from interactive streaming where, if a customer wants to listen to a particular recording of a particular song, the streaming company must have rights to that recording. This has two consequences. First, the licensees' market power vis-à-vis the Label is much higher than when negotiating rights for interactive streaming. This means licensees, in general, can expect to pay much lower Label royalties than they have to pay in connection with interactive streaming, RESTRICTED [redacted]. Second, the value of the musical work relative to the Label is much higher than with interactive streaming due to (1) the joint ownership of publishing rights, which makes each publisher much closer to a must have, and (2) the potential for creating a cover. A similar dynamic holds with the other audio-visual licenses Eisenach examined.

156. **Fitness and Lifestyle Companies:** Fitness and lifestyle products are fundamentally different from interactive streaming. Unlike in interactive streaming, users of fitness and lifestyle products do not require specific recordings that they must have available on demand. Like movie producers, fitness and lifestyle companies can forgo music from one Label and still create a viable service. For example, an instructor for a fitness class could choose songs in a particular catalog that is made available to that instructor. There is no need to have every single Label's catalog as there is for interactive streaming companies--even having one major Label's catalog

[212] Eisenach WDT ¶108.

would provide lots of present and past hits. Fitness services could also create cover songs for their classes or create entirely original music. Fitness services may be willing to RESTRICTED simply because they know Labels do not have the bargaining power to demand high royalties.

157. **Social Media Services:** Social media services, like TikTok and Snap, are also very different from interactive streaming. Again, consumers do not use these services to call up the recordings they want to hear on demand. Therefore, the services could function without music from one particular Label. In addition, users often create videos of themselves singing songs, without using the underlying recording. Therefore, while with interactive streaming every use of a musical work also involves use of a sound recording, on social media, users often use the musical work without using a sound recording, thus increasing the value of the musical work relative to the sound recording. I also understand that these services are protected from certain damages from copyright infringement by the Digital Millennium Copyright Act ("DMCA"), which further impacts the licensing power dynamics as compared to interactive streaming. Again, these services may be willing to grant Publishers RESTRICTED because they know Labels will not be able to demand high royalties.

158. **YouTube:** YouTube also differs from interactive streaming. YouTube allows users to see a wide variety of videos—comical videos, fitness videos, dance performances, videos with no music. Unlike with interactive streaming, the service could continue to exist without licenses from all Labels. Like Social Media services, I understand YouTube is also protected from certain damages from infringement by the DMCA, which further impacts negotiations. Therefore, YouTube agreements, like social media, lifestyle, and fitness agreements, do not constitute comparable benchmarks for interactive streaming.

3. RESTRICTED Do Not Provide Evidence for the Copyright Owners' Proposal

159. Finally, Eisenach presents evidence that RESTRICTED . He claims this shows that the *Phono III* rates "constitute a ceiling on what music Publishers can negotiate and thus must be considered a floor" for "rates going forward."[213]

[213] Eisenach WDT ¶102.

160. Obviously, this evidence cannot be called benchmark evidence for the Copyright Owners' proposal. The Copyright Owners' proposal includes rates that would produce royalties that are, as Eisenach calculated, and as I noted above, on average RESTRICTED than the highest *Phono III* rates. *Phonorecords III* also included free trials, student/family discounts, and tiered minima, none of which the Copyright Owners incorporate into their proposal here.

VI. COPYRIGHT OWNERS EXPERTS MAKE ADDITIONAL FLAWED ARGUMENTS FOR PREMIUMS TO STATUTORY RATES

161. The Copyright Owners' experts make several other arguments that they claim support adopting premiums for statutory rates. They argue that (1) the WBWS standard purportedly requires a rate increase over the rates adopted under the 801(b) factors, (2) Services are purportedly more able to withstand risk than publishers and songwriters, and (3) purported regulatory lag and potential for error requires adopting higher rates. These arguments are unsupported, inconsistent with the record, and/or inconsistent with the standard governing this proceeding. I discuss them below.

A. The WBWS Standard Does Not Require An Increase In Statutory Rates

162. The Copyright Owners' experts (particularly Eisenach) claim that the shift to the WBWS standard requires an increase in statutory rates. He writes:

> "While the Board's application of the 801(b) factors often dovetailed with the concept of fair market value, and supported the use of market-based benchmarks, the 801(b) factors – and particularly the non-disruption component – were generally understood to create a downward bias relative to free-market rates. Recognizing this, Copyright Owners were among the advocates for adoption of the new willing buyer/willing seller standard in the MMA."[214]

163. According to Eisenach, the WBWS standard requires an increase in rates because the Judges no longer need to worry about the non-disruption factor; in other words, they can increase rates that the Services must pay without concerning themselves with whether the higher rates will disrupt the Services' business models. I disagree. There is nothing inherent in the change of standard from 801(b) to WBWS that necessitates a change in rates.

[214] Eisenach WDT ¶29 (footnotes omitted).

164. The 801(b) factors called for many elements of a market-based result.[215] These include fair returns to the parties that reflect their contributions and that maximize the availability of creative works (which would happen if participants received fair returns for their contributions), without excessively disrupting the industry. It is this fourth factor—minimizing disruption to the industry—that Eisenach believes depresses rates. But he is incorrect. Because the WBWS standard calls for acceptance by 'most' willing buyers,[216] there is no economic basis for believing that a disruptive change in rates would be willingly accepted by *most* Services. Therefore, it is not necessarily true that the removal of the non-disruption factor will require any meaningful change in rates.

165. Eisenach cites as evidence only theoretical claims he made in his own writings and in the writings of an executive of Royalty Network, a music publisher.[217] Real world evidence points in the other direction. As I noted in my original report, the rates agreed to by Copyright Owners for physical phonorecords and PDDs in a 2021 settlement for *Phono IV* (under the WBWS standard) were the same as those under the *Phono III* settlement (under the 801(b) factors).[218] This supports my contention that there is no economic reason why a shift to a WBWS standard requires an increase in rates.[219]

166. In short, there is nothing in the WBWS standard that requires a premium to rates.

[215] 17 U.S.C. § 801(b)(1). These factors are: (i) To maximize the availability of creative works to the public; (ii) To afford the copyright owner a fair return for his or her creative work and the copyright user a fair income under existing economic conditions; (iii) To reflect the relative roles of the copyright owner and the copyright user in the product made available to the public with respect to the relative creative contribution, technological contribution, capital investment, Copyright Owners, risk, and contribution to the opening of new markets for creative expression and media for their communication; and (iv) to minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices.
[216] *Web I* Final Determination at 45244-45
[217] *See* Eisenach WDT ¶29 (fn 25).
[218] *See* Prowse WDT, ¶¶188-194.
[219] Here, too, the fact that the CRB recently ruled that the rates paid for digital downloads was too low does not change my opinion. The shift to a WBWS standard happened recently and it did not trigger a shift in rates, something I would expect if Eisenach were correct.

B. Copyright Owners Experts' Incorrectly Claim That The Relative Risks Between The Services And Copyright Owners Require A Premium To Royalty Rates

1. The higher cash reserves of the three largest Services do not mean they have more bargaining power

167. Eisenach argues that because the Services have high cash reserves, they have a much higher risk tolerance and hence bargaining power. He writes:

> "Differential risk tolerances can also lead to one party to a bargain to be more patient to reach an agreement than the other and, again, extract more from the bargain than its economic contribution would otherwise justify. In this regard, Apple held over $34 billion in cash and cash equivalents at the end of third-quarter 2021, Amazon reported over $40 billion in cash and cash equivalents at the end of second-quarter 2021, and Alphabet reported $23.6 billion in cash and cash equivalents at the end of second-quarter 2021. These vast sums mean that the Platforms have minimal borrowing costs and a high tolerance for risk, which translates directly into the ability to extract a disproportionate share of the surplus."[220]

168. He has confused several distinct issues in his argument. First, from an economic perspective, it is the health of a company that matters when it is engaged in negotiations, not its cash reserves alone. If a company can readily raise debt or issue new stock, for example, it can be patient as well. The largest Publishers—Sony/ATV Music Publishing, Warner/Chappell Music and Universal Music Publishing Group—control over 60% of the market.[221] All these companies are part of financially strong parent companies. The same is true of the major sound recording companies, the three largest of which, incidentally, have the same parents as the three largest Publishers: Sony Music Entertainment, Warner Music Group and Universal Music Group.[222]

[220] Eisenach WDT ¶67 (footnotes omitted).
[221] The Register of Copyrights, "Copyright and the Music Marketplace," U.S. Copyright Office, February 2015 at 19. http://copyright.gov/docs/musiclicensingstudy/copyright-and-the-music-marketplace.pdf (last accessed 3/5/22)
[222] The Register of Copyrights, "Copyright and the Music Marketplace," U.S. Copyright Office, February 2015 at 23. http://copyright.gov/docs/musiclicensingstudy/copyright-and-the-music-marketplace.pdf (last accessed 3/5/22)

169. Eisenach is also incorrect as a matter of empirical evidence. Spotify and Pandora do not have comparable cash reserves to the "Big Three Platforms"[223] RESTRICTED [redacted][224]

170. Finally, any particular streaming company needs to have every major publishing and sound recording catalog. Therefore, regardless of cash reserves, "anxiousness" in a negotiation is more likely to extend to Services that 'must have' catalogs, the lack of any of which could make their streaming business nonviable, than it would to Labels and Publishers, who can afford to be more patient because their songs are available on the platforms of other streaming companies. Eisenach is simply incorrect. Higher cash reserves do not imply greater bargaining power.

2. Any Alleged Extra Risks Faced by Songwriters Can Be Addressed Through Minima

171. Watt writes that individual songwriters may have a stronger preference for current income than do the Services, who may be willing to discount "subscription fees in the present in order to fight for market share and increase their user base, perhaps in the hope that higher revenues can be earned in the future (or perhaps in pursuit of current or future parallel revenue)."[225] This is incorrect for a number of reasons. First, the Copyright Owners' experts have not provided any meaningful evidence of revenue displacement or deferral, so this argument is speculative at best. Second, any concerns about revenues can be addressed through the appropriate setting of minima, which are designed to address such concerns. In short, Watt has not provided any basis for believing that any adjustment to rates is necessary to account for any risk differentials.

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[223] According to Eisenach, Apple, Amazon and Alphabet had $34 billion, $40 billion, and $23 billion on hand in Q3, Q2 and Q2, respectively, of 2021. Eisenach WDT ¶67. Spotify had $2.4 billion as of Q2 2021 Spotify Q2 2021 10Q, at 6; Pandora was acquired in 2019 by Sirius XM, which as of Q2 2021 held $1.1 billion in cash and cash equivalents. Sirius XM Q2 2021 10Q, at 6.

[224] *See, e.g.*, Spotify's payments of sound recording royalties in **Table 2** above, RESTRICTED The Segal WDT at ¶55 shows that Apple pays an effective royalty rate of [redacted] in sound recording royalties to Labels. For deals within the regulatory shadow, see the following Publisher deals: PAN_PHONO4_00000395 (Pandora-Warner/Chappel); PAN_PHONO4_00000226 (Pandora-Sony/ATV).

[225] Watt WDT, ¶80.

C. Eisenach Incorrectly Claims That The Possibility Of Regulatory Error And Regulatory Lag Requires a Premium

1. The Board should not set rates based on an assumption Services will negotiate lower rates if the statutory rates are too high

172. Eisenach argues that the Board should determine a range of reasonable royalties and then choose towards the upper end of that range due to the possibility of regulatory error. His argument is that if the CRB makes a mistake and sets rates too low, Copyright Owners would be harmed because the Services might have been willing to pay more. He claims it is better to err on the side of setting rates a little too high because in that case the parties could simply agree to lower rates voluntarily. He writes:

> "…the Judges may be presented with a range of reasonable rates supported by the evidence. In that situation, I believe that there are a number of reasons why the Judges should choose near the top of that range."[226]

173. The rationale offered by Eisenach is similar to the rationale offered under what is known as the 'bargaining room theory.' According to the Dissent in *Phono III*, the original rationale for the bargaining room theory was offered by Mr. Robert Nathan, an expert witness for the NMPA, in 1967 in Congressional testimony:

> "When setting a statutory or regulatory rate, the rate-setter should allow for 'opening up of the bargaining range [with] a higher ceiling so that more bargaining can take place,' [according to Mr. Nathan] which would 'permit competitive bargaining…'"[227]

174. Eisenach offers a similar claim, that the Judges should set a rate higher than they might otherwise to account for the possibility of regulatory error (*i.e.,* the possibility that the CRB errs in setting rates too low) or regulatory lag (*i.e.,* the market changes more quickly than the statutory period of five years). He writes:

> "The way to factor in this risk [of regulatory error and lag] is precisely to assess options within a range of reasonable rates by their likelihood of achieving market rates. In such an analysis, it becomes clear that higher rates, *all else equal*, will be more likely to achieve market rates, because

[226] Eisenach WDT ¶35.
[227] *Phono III* Dissent at 23.

> compulsory rates above the market rate will still produce market rates, while compulsory rates below the market rate will not."[228]

175. But Eisenach ignores transaction costs. Congress has decided royalty rates should be set by the CRB and not just negotiated by independent market participants. There were several reasons for this decision, but one important reason was to minimize transaction costs.[229] It is costly to negotiate royalty agreements and a statutory rate helps minimize those costs. It is not correct that the CRB should simply set the rate higher in case it makes a mistake. To do so is to make it more likely that parties will engage in the type of costly negotiation that the statutory scheme was, in part, designed to avoid.

176. In addition, I am not aware of any agreements where the Copyright Owners have negotiated headline revenue rates or PSMs lower than the statutory rate—and none of the Copyright Owners' experts point to any.

2. No risk premium should be added to account for the shorter term of market agreements

177. Both Watt and Eisenach argue that a risk premium should be added to any rates derived from market-based Label agreements because most such agreements RESTRICTED [redacted] than the statutory period (five years). They argue that market-based agreements can be renewed at different terms based on changing market conditions and hence are less risky than statutory rates which are changed only every five years.

178. There are several reasons why this argument is incorrect. First, RESTRICTED [redacted] this concern is overstated. Second, the Services face risk as well—particularly intense competitive risks--and neither Eisenach nor Watt has shown that the risk of a longer statutory period affects Publishers more than Services. Third, the parties have previously voluntarily agreed to a flexible structure that includes a revenue prong and a PSM that is specifically designed to protect against revenue deferral concerns. There is no reason to think that a revenue prong (which generally aligns the incentives of the Services and Publishers in growing the customer base) paired with PSMs (to protect against revenue deferral) would be ineffective as the market evolved.

[228] Eisenach WDT ¶38. [emphasis in original]
[229] *Phono III* Dissent at 25.

179. Dr. Eisenach also contends that *Phono IV* rates should be set even higher than what his flawed benchmarks from sound recording rates would suggest "to reflect current and likely future trends."[230] and that "if current trends were – however surprisingly – to reverse, the parties would be free to negotiate alternative agreements.[231] By this, he seems to be referring to a RESTRICTED [redacted] These are curious statements and contradicts the See-Saw theory. The *Phono III* rates, after all, are an increase over the *Phono II* rates[232]; and the Copyright Owners are pushing for even higher rates in this proceeding. Eisenach, at least, thinks it would be quite "surprising" to see sound recording rates decline.

180. In any case, there is no reason to think that every increase in Label payments means there should also be an increase in payments to Copyright Owners. This is a fundamental flaw with the Copyright Owners' approach. They assume that Label and Publishers/songwriter payments should be linked when there are good economic reasons not to link them. For example, Labels provide sound recordings to Services, a distinct product from the musical works that Publishers and songwriters provide. Labels may improve their product without any change in the musical works that publishers and songwriters provide, accounting for Labels' ability to demand higher payments for this improvement. Given that, a risk premium or a periodic re-assessment of the PSM and PPR, like the Copyright Owners propose, to purportedly help mechanical royalties keep pace with Label royalties is illogical. Further, as I already noted, the PSM is *already* out of step with Label rates because the Copyright Owners have not incorporated any adjustments to the PSM for students, family plans, trials, a limited functionality offering, or bundles.

181. For all these reasons, there is no justification for a risk premium to account for the fact that the term of five years for the statutory period is longer than that of market-based agreements.

VII. INTERACTIVE STREAMING HAS NOT CAUSED PUBLISHERS TO LOSE REVENUES

182. Finally, as I explained above and in my prior report, the growth of interactive streaming has been a boon for Copyright Owners. The Copyright Owners have achieved substantial growth

[230] Eisenach WDT ¶ 101.
[231] Eisenach WDT fn. 104.
[232] Copyright Owners touted that the headline rate was a 44% increase after the *Phono III* Final Determination. *See*, *e.g.,* Ian Courtney, "Copyright Royalty Board Starts the Final Countdown for New Mechanical Rates," Celebrity Access 2/5/19 (quoting David Israel of the NMPA). https://celebrityaccess.com/2019/02/05/copyright-royalty-board-starts-the-final-countdown-for-new-mechanical-rates/. [last accessed 4.22.22]

in revenue from interactive streaming and from other services, like social media, gaming, and fitness, that several of the Services' platforms facilitate. Given the Copyright Owners' growth in royalties as a result of interactive streaming, and the fact that the royalty terms align the interests of the Services and the Copyright Owners (minima, student and family discounts, tiered PSMs), there is no economic reason to increase the share of royalties going to Copyright Owners. Copyright Owners will continue to share in any growth in the subscriber base and their royalty levels will be protected under the current minima.

183. Nonetheless, the Copyright Owners' witnesses claim that they have suffered losses due to interactive streaming and that (i) RESTRICTED [redacted]. As I explain below, neither of these claims is true. Rather, the data shows that interactive streaming RESTRICTED [redacted].

A. Royalties from RESTRICTED [redacted]

184. Several witnesses for Copyright Owners (Beekman, Kelly, Yocum) claim that royalties from interactive streaming are too low because RESTRICTED [redacted][233] JW Beekman, Global Chief Financial Officer at Universal, writes that, "…total interactive audio streaming **mechanical income** in 2020 was still RESTRICTED [redacted] of UMPG's and its writers' mechanical income in 2009 from physical recordings and digital downloads."[234] Thomas Kelly, Global Chief Financial Officer at Sony, writes that, "… RESTRICTED [redacted]

[233] For purposes of this Section, I have not independently verified the numbers presented by the executives at the Publishers UMPG, SMP and Warner/Chappell. I do not intend to convey that I accept the accuracy of these numbers.
[234] Beekman WDT ¶55 (footnote omitted) [emphasis added].

RESTRICTED ."[235] And Annette Yocum, Vice President of Finance for Warner, writes:

> "…total non-streaming mechanical income RESTRICTED During this same time period, Warner Chappell's domestic **mechanical income** from interactive audio streaming services increased from RESTRICTED (See COEX- 6.2, line 125.) Thus, the RESTRICTED "[236]

185. Comparing only mechanical income levels under interactive streaming and digital downloads and physical sales is incorrect for two reasons. First, digital downloads and physical sales generate *only* mechanical revenues but interactive streaming generates mechanical revenues *as well as* performance royalties. Performance royalties are collected by songwriters through PROs as well as through Publishers, who receive approximately half of the performance royalties from the interactive streaming companies. To assess whether increases in interactive streaming royalties have offset losses in royalties from digital downloads and physical sales, one must include all the royalties the interactive streaming services generate, including performance royalties.

186. Second, one must consider other sources of royalties that have also contributed to the decline in digital downloads/physical sales—that are also generating revenues for Copyright Owners. Interactive audiovisual streaming is one obvious example.[237] As noted by Kelly,

> "…the growth of interactive audio streaming and interactive audiovisual streaming has substituted for many of the other forms of exploitation that previously provided us and our songwriters with a higher level of mechanical income."[238]

[235] Kelly para 11 (footnote omitted). [emphasis added]
[236] Yocum WDT ¶¶46-47. [emphasis added]
[237] For reasons stated above, audiovisual agreements are not appropriate benchmarks for interactive streaming because, first, users use these services differently and, second, due to the differences in relative bargaining power the audiovisual services have relative to the Labels and publishers compared to interactive streaming services. But this is a distinct issue from whether consumers on audiovisual services may, to some degree, use audiovisual platforms, like YouTube, to listen to (and watch) songs they may otherwise have chosen to purchase.
[238] Kelly WDT ¶12.

187. Beekman as well notes that there are "newly developing interactive audio/visual services (YouTube is not a new service), which I view as competing with the interactive audio services and not being promoted by them."[239]

188. There are also other sources of revenues that replace lost royalties from physical sales and digital downloads. For example, John Hauser, an expert witness for Spotify, opined that if their Spotify Premium account were not available, consumers would consider listening to a broad array of alternatives such as non-interactive streaming or previously purchased music for which Copyright Owners receive no additional royalties, meaning that it is possible that a portion of the royalties from these sources should also be considered in assessing the decline in royalties from digital downloads/physical sales.[240] One must include royalties from all of these additional sources to assess whether revenues from lost digital downloads and physical sales have been replaced.

189. The Publishers have not produced (and may not have) the specific data necessary to determine what portion of these other services replaced digital downloads and physical sales. Nevertheless, the data they have produced—even though it is a subset of all the revenues that should be included—[redacted] recouped. Below I present the data for each of the three major Publishers.

UMPG

190. Beekman (from UMPG) writes that mechanical income from digital downloads and physical sales were [redacted][241]) and [redacted],[242] a [redacted]. Interactive audio streaming royalties, including performance royalties, were, according to UMPG, [redacted] in 2020.[243] So even before considering royalties from interactive audiovisual streaming, non-interactive streaming, and the other forms of music consumption that substitute for digital downloads and physical sales,

[239] Beekman WDT ¶78.
[240] Hauser WDT ¶12, Appendix S-1 and Appendix T-1.
[241] The Pending/Unmatched royalties amounts refers to additional amounts UMPG is expected to receive [redacted] Beekman WDT ¶45, fn. 3.
[242] Beekman WDT ¶54.
[243] Beekman WDT ¶59.

RESTRICTED

RESTRICTED

SMP

191. SMP's data shows the same effect. Royalties from digital downloads and physical sales were RESTRICTED in 2009,[245] and RESTRICTED,[246] RESTRICTED Royalties from interactive audio streaming for 2020 were $ RESTRICTED [247] Here, too, this is before considering any data from additional royalties, such as interactive audiovisual

[244] *See* **Exhibit 6** for detailed references for **Table 5**.
[245] Kelly WDT ¶62.
[246] Calculated from COEX-4.7, which shows total mechanical income of $97.1 million, less mechanical income from streaming (from COEX-4.8) of $73.5 million.
[247] Line 15 of COEX-4.10. I RESTRICTED

streaming, non-interactive streaming, and other products that substitute for digital downloads and physical sales. *See* **Table 6** below.[248]

RESTRICTED

Warner/Chappell

192. In 2009, Warner/Chappell had royalties from digital downloads and physical sales of RESTRICTED,[249] declining to RESTRICTED in 2020,[250] RESTRICTED. Warner/Chappell's data for royalties from interactive streaming services is incomplete for 2020:

RESTRICTED

This is apparent from COEX-6.6, RESTRICTED

[248] *See* **Exhibit 7** for detailed references for **Table 6**.
[249] *See* Yocum WDT ¶48.
[250] Yocum WDT ¶48. The decline is $65 million if the pending/unmatched payment is excluded.
[251] Yocum WDT footnote 7.
[252] Yocum WDT ¶55.
[253] Yocum WDT ¶56. ($20.5 million share of publisher revenues multiplied by 2).
[254] COEX-6.6. Obtained by summing "Total Digital" amounts in line 8 for ASCAP and BMI of the "2019 Digital" tab.
[255] COEX-6.6. Obtained by summing "Total Digital" amounts in line 15 for ASCAP and BMI of the "2020 Digital" tab.

193. One could also do the calculation using only 2019 data. In 2019, royalties from digital downloads/physical sales were RESTRICTED,[256] for a RESTRICTED from 2009. Mechanical royalties from interactive streaming were RESTRICTED,[257] and performance royalties for interactive streaming were RESTRICTED,[258] for a total of RESTRICTED, which exceeds the decline of RESTRICTED

194. Whether the calculations are done using 2019 or 2020 data, RESTRICTED . And this is before including any additional amounts from other sources of royalties (such as interactive audiovisual streaming, and non-interactive streaming) that substitute for digital downloads/physical sales. Yocum acknowledges that RESTRICTED .[259]

RESTRICTED

Other Publishers

195. I have also reviewed the financial documents produced by some additional, smaller publishers. While not always complete, this data, too, shows for three additional Publishers that RESTRICTED [260] This is true of Kobalt, ABCKO, and BMG.

[256] COEX-6.2, sum of lines 22, 101 and 113.
[257] COEX-6.2, line 125.
[258] Yocum WDT ¶56.
[259] Yocum WDT fn 9: "Performance income from interactive audiovisual services, including YouTube and other services that did not exist in 2016, RESTRICTED ." *See*, **Exhibit 8**.
[260] Data from the following Publishers was not sufficiently complete for me to form an opinion on whether RESTRICTED physical sales and digital downloads: Concord, Hipgnosis, Reservoir, Roundhill, peermusic, and Downtown.

196. **Kobalt** paid mechanical income royalties of RESTRICTED in 2009.[261] In 2020, it paid mechanical income royalties (not counting performance royalties) from all sources of RESTRICTED [262] and mechanical royalties paid in connection with from streaming were RESTRICTED [263] Streaming royalties alone have therefore RESTRICTED

197. **ABCKO** has produced financial information that is in some respects incomplete but appears to be sufficient to show that RESTRICTED between 2009 and 2020. ABCKO has produced data showing that it owed RESTRICTED in 2009 for physical sales and digital downloads.[264] In 2020, it owed mechanical royalties from physical sales, digital downloads and subscription based audio streaming of at leas RESTRICTED[265] Even without including performance royalties from interactive streaming, it appears from the limited data that ABCKO has provided that royalties from interactive streaming have RESTRICTED

198. **BMG's** financials are also incomplete but also appear to show that RESTRICTED . I compared the data from 2020 to the data in 2010.[266] Royalties BMG paid to artists in 2010 were RESTRICTED million.[267] There are two limitations to this 2010 data, but it is possible to make reasonable estimates to get around these problems. The first limitation is the that the 2010 data is the amounts paid to artists only (not artists plus publishers). However, it is possible to estimate what the total royalties were (artists plus publishers) by looking at the ratio of total royalties to royalty expense (the portion paid to artists) from 2017 to 2020 and applying that ratio to the value in

[261] P4_KOBALT00000933. The 'Pivot Summary' tab provides totals filtered on the U.S. and on mechanical income.
[262] P4_KOBALT00000934. The 'Pivot Summary' tab provides totals filtered on the U.S. and on mechanical income.
[263] P4_KOBALT00000934. I obtained this amount by filtering on "Mechanical Online – Streaming."
[264] P4_ABCKO00014531. I conservatively assumed that all the amounts shown were for physical sales and digital downloads.
[265] It is not possible to determine these amounts precisely from the incomplete information ABCKO has provided. P4_ABCKO00014496. I filtered column B to include only data for 2020 and I filtered column E to include amounts for 'Mechanical (DD)' (which I take to be mechanical income from digital downloads), 'Mechanical (P)' (which I take to be mechanical income from physical sales) and Streaming Aud. (subscr), (which I take to be interactive audio streaming). I also assumed that column G ("sum of sum of royalties") represented the royalties owed and that this would be comparable to the amounts shown for 2009 (that those amounts were amounts actually owed to artists).
[266] I used 2010 as the baseline in this comparison because data for 2009 was only RESTRICTED
[267] P4_BMG00446276. I obtained this as the amount paid in royalties to artists in column I.

2010. Data from 2017 – 2020 shows that artists received [redacted] of total mechanical royalties from physical sales.[268] Assuming the same percentage applied in 2010, total royalties (artists plus publisher amounts) would have been [redacted]. BMG does not break out the 2010 data by source of income (mechanical, performance, etc.) so mechanical income from physical sales and digital downloads cannot have been more than [redacted]

199. In 2020, the royalties for interactive streaming were greater than this amount. BMG has produced a spreadsheet showing royalty amounts earned from interactive streaming companies. In 2020, mechanical and performance royalties for interactive streaming alone (that is, not counting any royalties from physical sales and digital downloads) was [redacted][269] This amount already exceeds the conservative 2010 amount shown above of [redacted]. Moreover, BMG's data also shows that mechanical income from physical sales were [redacted] in 2020.[270] Any [redacted]

B. Data Concerning Songwriter Advances Do Not Support a Rate Increase

200. Music publishing companies make advances to songwriters and then hope to recoup those advances as royalties are collected. An advance by a publisher represents an economic investment: it is a way for the songwriter to get an upfront payment and for the publisher to share (the Net Publisher Share) in future royalties in excess of the advance.[271] If Publishers are rational economic agents (and I have seen no evidence that they are not), they make advances in the expectation that they will receive a return on their investment (that is, a return of their advance plus a profit). The making of advances is a healthy financial sign in the industry. It suggests Publishers are willing to make investments in the expectation of receiving returns on their investments, and that they expect royalties to increase so they are able to recoup the increasing advances.

[268] P4_BMG00445865. Obtained by summing the values in rows 6 and 15 for 2017 to 2020 and dividing the sum of mechanical royalty expense from physical sales (row 15) by the sum of mechanical revenue from physical sales (row 6).
[269] P4_BMG00446207. I got this by filtering for 2020, including all companies except YouTube and Pandora, and counting only mechanical and performance income.
[270] P4_BMG00445865. This amount is for all of North America, but I would expect that the bulk of it relates to the United States.
[271] Yocum WDT ¶27-29.

[redacted][272]

RESTRICTED

202. It is to be expected that as advances grow, so will unrecouped advances. Whenever an advance is made, the recoupment of royalties may be expected to take place over a period of several years. This necessarily means that the overall balance of unrecouped advances will also grow. I would also expect that Publishers will invest in a 'portfolio' of songwriters. That is, they will make investments on an aggregate basis, expecting some to fail and some to succeed, with the successes outpacing the failures. RESTRICTED [redacted] David Kokakis, Chief Counsel at UMPG, writes:

> "While we hope that in any given year our annualized amount of advances will be recouped in an amount equal to or greater than our outlay, as further described in the direct witness testimony of UMPG's Global Chief Financial Officer, JW Beekman, RESTRICTED [redacted]. (See Beekman WDT ¶ 23.) RESTRICTED [redacted][273]

203. Beekman writes that this justifies RESTRICTED [redacted]

[272] COEX-1.1, COEX-4.3, COEX-6.2, COEX-3.3.
[273] Kokakis WDT ¶48.

> "This too is part of the reason why music publishers and writers are focused on protecting, indeed, enhancing, the income received from RESTRICTED [redacted][274]

204. But the Publishers have not presented any data or analysis showing that these unrecouped advances have lost value or, more specifically, that the prognosis for recouping these advances has worsened from the time they were made. Without such a showing—which would mean they are all making systematically poor financial evaluations of artists—their claims about unrecouped advances cannot be verified.

205. I have seen no evidence that the Publishers are making systematically irrational economic decisions with respect to advances to songwriters. RESTRICTED [redacted]

RESTRICTED [redacted]

[274] Beekman WDT ¶6.
[275] SMP did not produce this data. EBITDA stands for Earnings Before Interest Taxes Depreciation and Amortization and is similar to OIBDA which stands for Operating Income Before Depreciation and Amortization. Both are considered measures of cash flows.
[276] COEX-1.5 line 152 (UMG) & COEX-6.2 line 458 (Warner).

C. Publishers Have Significant Profits

206. Lastly, I collected the financial results (net income) for the Publishers for whom I have this data. I present the results in **Table 10**.

207. As can be seen, for each of the Publishers except Peermusic, their RESTRICTED [redacted] In 2020, the weighted average net income margin (net income divided by sales) across all Publishers for whom I have data was [redacted].

VIII. CONCLUSION

208. The Copyright Owners have proposed extraordinarily high increases in musical works royalties—far higher than were negotiated in the *Phono II* Settlement and far higher than the *Phono III* rates currently on remand. The economic experts for the Copyright Owners attempt to justify these increases on economic grounds but fail. Instead of looking primarily to market agreements involving substantially the same licensors and licensees and the same rights (for interactive audio without video), the Copyright Owners' experts rely primarily instead on flawed economic models and theories and non-comparable Label and audio-visual agreements.

209. The Copyright Owners' experts' claims depend, firstly, on a theory that requires sound recording and musical works royalties to 'See-Saw' for which they provide no evidence and is in

fact contradicted by the available evidence. Second, they posit the existence of complementary income—income that music allegedly drives in the non-music businesses of the Services. But they fail to quantify this complementary income in any meaningful way or take account of the benefits that flow from the other non-music businesses towards music, or the benefits that the Services' platforms make available to Copyright Owners in *their* other businesses. Furthermore, this theory requires that the Labels have no idea that this complementary income exists. Under the Copyright Owners' theory, if the Labels did guess at the existence of this complementary income, they would make an estimate or allowance for it—and extract it during their negotiations with the Services. This theory is highly implausible.

210. Third, along with the See-Saw theory, the Copyright Owners' experts rely upon a RESTRICTED ratio of sound recording to publisher royalties. But this ratio—derived from the *Phono III* Determination—is before an adjustment for market power. The Judges specifically adjusted this ratio for the market power of the Labels and determined a significantly higher ratio. The Copyright Owners justify this incorrect RESTRICTED ratio—arguing that it should be even lower—by developing a Shapley analysis, an economic model that is untethered to reality, which they use to generate arbitrarily high royalties with no grounding in the evidence.

211. When the Copyright Owners' experts turn to market-based agreements, they rely heavily on non-comparable agreements, particularly audio-visual agreements and Label agreements that need to be adjusted, rather than the far more comparable publishing agreements and PRO agreements for interactive music streaming. For the Label agreements, they make adjustments based on the flawed RESTRICTED ratio that does not adjust for the market power of the Labels or otherwise comport with evidence regarding RESTRICTED . And the audio-visual agreements entail very different bargaining power levels between the parties and are therefore not comparable to agreements between the Services and Publishers.

212. I continue to believe the *Phono II* Settlement without the TCC prong is a reasonable starting point for setting rates and that RESTRICTED . As I explained in the Prowse WDT, any concerns about revenue deferral and displacement can be addressed by the setting of appropriate minima, as Apple has proposed.

Stephen D. Prowse

April 22, 2022

EXHIBIT 1
DOCUMENTS RELIED UPON

Bates Stamped Documents

Beginning Bates	*End Bates*
AMZN_Phono_IV_00015463	AMZN_Phono_IV_00015463
APL-046	
APL-076	
APL_PHONO_00004529	APL_PHONO_00004639
APL_PHONO_00004814	APL_PHONO_00004844
APL_PHONO_00005273	APL_PHONO_00005293
APL_PHONO_00005334	APL_PHONO_00005345
APL_PHONO4_00000042	APL_PHONO4_00000048
APL_PHONO4_00000049	APL_PHONO4_00000054
APL_PHONO4_00000055	APL_PHONO4_00000057
APL_PHONO4_00000058	APL_PHONO4_00000061
APL_PHONO4_00000062	APL_PHONO4_00000081
APL_PHONO4_00000082	APL_PHONO4_00000092
APL_PHONO4_00000093	APL_PHONO4_00000114
APL_PHONO4_00000123	APL_PHONO4_00000124
APL_PHONO4_00000128	APL_PHONO4_00000129
APL_PHONO4_00000130	APL_PHONO4_00000132
APL_PHONO4_00000156	APL_PHONO4_00000157
APL_PHONO4_00000160	APL_PHONO4_00000161
APL_PHONO4_00000176	APL_PHONO4_00000181
APL_PHONO4_00000182	APL_PHONO4_00000185
APL_PHONO4_00000227	APL_PHONO4_00000231
APL_PHONO4_00000472	APL_PHONO4_00000472
APL_PHONO4_00000473	APL_PHONO4_00000482
APL_PHONO4_00000519	APL_PHONO4_00000566
APL_PHONO4_00000567	APL_PHONO4_00000625
APL_PHONO4_00000626	APL_PHONO4_00000670
APL_PHONO4_00000711	APL_PHONO4_00000728
APL_PHONO4_00000732	APL_PHONO4_00000751
APL_PHONO4_00000752	APL_PHONO4_00000771
APL_PHONO4_00000812	APL_PHONO4_00000831
APL_PHONO4_00000832	APL_PHONO4_00000851
APL_PHONO4_00000872	APL_PHONO4_00000891
APL_PHONO4_00000993	APL_PHONO4_00001012
APL_PHONO4_00001113	APL_PHONO4_00001132
APL_PHONO4_00001158	APL_PHONO4_00001168
APL_PHONO4_00001169	APL_PHONO4_00001188
APL_PHONO4_00001189	APL_PHONO4_00001211
APL_PHONO4_00001233	APL_PHONO4_00001248
APL_PHONO4_00001468	APL_PHONO4_00001469
APL_PHONO4_00001525	APL_PHONO4_00001525
APL_PHONO4_00001680	APL_PHONO4_00001699
APL_PHONO4_00001700	APL_PHONO4_00001713
APL_PHONO4_00001745	APL_PHONO4_00001755
APL_PHONO4_00008386	APL_PHONO4_00008418
APL_PHONO4_00008651	APL_PHONO4_00008664

EXHIBIT 1
DOCUMENTS RELIED UPON

Bates Stamped Documents

Beginning Bates	*End Bates*
APL_PHONO4_00009519	APL_PHONO4_00009531
APL_PHONO4_00009550	APL_PHONO4_00009551
APL_PHONO4_00009555	APL_PHONO4_00009562
APL_PHONO4_00009631	APL_PHONO4_00009692
APL_PHONO4_00009693	APL_PHONO4_00009697
APL_PHONO4_00009698	APL_PHONO4_00009711
APL_PHONO4_00010045	APL_PHONO4_00010057
COEX-1.1 - Restricted	
COEX-1.3 - Restricted	COEX-1.5 - Restricted
COEX-3.3 - Restricted	
COEX-4.2 - Restricted	COEX-4.12 - Restricted
COEX-6.2 - Restricted	
COEX-6.5 - Restricted	
COEX-6.6 - Restricted	
COEX-7.30 - Restricted	
COEX-7.74 - Restricted	
P4_CONCORD00000390	P4_CONCORD00000390
P4_DOWNTOWN00067750	P4_DOWNTOWN00067750
P4_KOBALT00000151	P4_KOBALT00000151
P4_KOBALT00000152	P4_KOBALT00000152
P4_PEERMUSIC00005302	P4_PEERMUSIC00005341
P4_PEERMUSIC00005322	P4_PEERMUSIC00005341
P4_PEERMUSIC00005342	P4_PEERMUSIC00005361
P4_SMP00000716	P4_SMP00000716
PAN_PHONO4_00000226	PAN_PHONO4_00000243
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EXHIBIT 2

UPDATED SELECT APPLE LICENSE AGREEMENTS WITH PUBLISHERS AND PROS[1]

	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)
#	Bates No.	Relevant Amendment Bates No(s).	Licensor Type	Licensor	Licensee	Relevant Licensed Activity	TCC Prong?	Revenue-Based?	All-In?	Per Subscriber Minimum?	Proportional Allocation of Service Bundle Revenue?	Floor / No Revenue Prong for Hardware Bundles?	Family and Student Discounts (1.5x and 0.5)?	Limited Functionality Plan Discount

Notes:
[1] My review of Apple's agreements is not intended to be exhaustive
[2] Apple released its limited functionality plan after these agreements terminated

EXHIBIT 3

REPRODUCTION OF EISENACH TABLE 4 USING PHONO II RATES

Service	Category	Musical Works		
		P2	Proposed	% Difference
By Service & Category				
Spotify	Subscription	RESTRICTED		
	Ad-Supported			
	Total			
Apple	Subscription			
	Ad-Supported			
	Total			
Amazon	Subscription			
	Ad-Supported			
	Total			
Google	Subscription			
	Ad-Supported			
	Total			
Pandora	Subscription			
	Ad-Supported			
	Total			
Others	Subscription			
	Ad-Supported			
	Total			
By Category				
All Services	Subscription	RESTRICTED		
	Ad-Supported			
Total				

Note: The exhibit is reproduced using the Stata program provided in the Eisenach WDT ("Royalties Data Analysis.do") and replacing the Phono III rates with the Phono II rates. In addition, the Phono II payable royalty pool uses the end users reported in calculating the Copyright Owners' proposed royalties. Per Eisenach WDT, "the Proposed Rates return the definition of subscriber under the per-subscriber prong to the definition used under Phonorecords I and Phonorecords II – *i.e.* , it does not allow for the artificial lowering of subscriber counts in the instances of family or student plans." (Eisenach WDT ¶ 69, Appendix C, ¶¶ 6-7)

EXHIBIT 4

REPRODUCTION OF EISENACH TABLE 4 USING FIRST YEAR OF PHONO III RATES

Service	Category	Musical Works		
		P3	Proposed	% Difference
By Service & Category				
Spotify	Subscription	RESTRICTED		
	Ad-Supported			
	Total			
Apple	Subscription			
	Ad-Supported			
	Total			
Amazon	Subscription			
	Ad-Supported			
	Total			
Google	Subscription			
	Ad-Supported			
	Total			
Pandora	Subscription			
	Ad-Supported			
	Total			
Others	Subscription			
	Ad-Supported			
	Total			
By Category				
All Services	Subscription	RESTRICTED		
	Ad-Supported			
Total				

Note: The exhibit is reproduced using the Stata program provided in the Eisenach WDT ("Royalties Data Analysis.do") and replacing the Phono III 2022 rates with the Phono III 2018 rates.

EXHIBIT 5
ANALYSIS OF MUSIC STREAMING PARTICIPANTS

Company Name	Pure Play in Streaming?	Other Activities	Standalone Company?	Owned By
Tidal [1, 2]	Yes	N/A	No	Square, Inc.
SoundCloud [3, 4]	Yes	Also uploads by users	Yes	N/A
iHeart [5, 6]	No	Broadcast Radio, social media, events	Yes	N/A
Melody VR [7, 8]	No	Staging virtual concerts	No	EVR Holdings plc
LiveXLive [9]	No	Pay-per-views, personalized merchandise, an NFT business	No	LiveOne, Inc.
Audiomack [10, 11]	Yes	N/A	Yes	N/A
Deezer [2, 3, 12]	Yes	N/A	No	Access Industries, Rotana Group, Kingdom Holding Company
nugs net [13, 14]	No	Downloads/Purchases, CD sales	Yes	N/A
JioSaavn [15, 16]	Yes	N/A	No	Reliance Industries Limited
Hoopla [17]	Yes	N/A	No	Midwest Tape
GTL (ViaPath) [18, 19, 20]	No	Inmate telephone systems, jail management systems, financial services, intelligence & investigative solutions, inmate tablets, and inmate education solutions	Yes	N/A
Qobuz [21]	No	Downloads/Purchases	No	Xandrie SA
TREBEL [22, 23]	Yes	N/A	No	M&M Media
Power Music [24]	No	Production of fitness music/videos/programs	Yes	N/A
Yes! Fitness Music [25, 26]	No	Production of fitness CDs, CD sales	Yes	N/A
Idagio [27, 28]	Yes	N/A	Yes	N/A
Sonos (Sonos Radio) [29, 30]	No	Smart home sound systems, connected home, speakers	No	Sonos, Inc.
Mixcloud [31, 32]	Yes	Also uploads by users	No	WndrCo LLC
FanLabel [33, 34]	No	Music gamification	No	Owned in part by the major record labels
Pacemaker [35, 36]	No	AI music technology	Yes	N/A
Classical Archives [37, 38]	Yes	N/A	Yes	N/A
Anghami [39]	Yes	N/A	Yes	N/A
Wolfgang's [40, 41]	No	Music memorabilia/merchandise	No	Norton LLC
Weav [42, 43]	No	Music gamification, augmented reality, fitness	Yes	N/A
PianoTrax [44]	No	Purchases/downloads, custom track production	Yes	N/A
Boomplay [45, 46]	No	Entertainment news	No	Transsion Holdings/Transsnet Music
Monking Me (OffBeat) [47]	No	Non-Fungible Tokens (NFTs)	Yes	N/A
Ultimate Guitar USA [48, 49]	No	Guitar tabs and chords, lessons, articles, social media	No	Muse Group
Naxos [50, 51]	No	Distribution, DVDs, CDs	No	HNH International, e-books, i-books
GrooveFox [52, 53]	Yes	N/A	Yes	N/A
The Cover Foundry [54, 55]	No	Music production	No	Avail LLC
Music Choice [56, 57]	Yes	Broadcast	No	Comcast, Time Warner, Cox Communications, EMI Music, Microsoft, Motorola, and Sony.

EXHIBIT 5
ANALYSIS OF MUSIC STREAMING PARTICIPANTS

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EXHIBIT 6

UMPG/SONGWRITER ROYALTIES, 2009 VS. 2020 ($000)

		2009	2020
[1]	Pending Unmatched[1]	RESTRICTED	
[2]	Mech. Royalties from CDs (Physical Sales)[2]		
[3]	Mech Royalties from Digital Downloads[3]		
[4]=[1]+[2]+[3]	**Total Royalties from Digital Downloads/CDs**		
[5]	Total Royalties from Interactive Streaming[4]		
[6]=[4]+[5]	***Total Royalties (DDs/CDs/Interactive)***		
[7]	Other Royalties		***not produced***
[8]=[6]+[7]	**Total Royalties (DDs/CDs/Interactive/AV)**		***Unknown***

Sources:

(1) Beckman WDT, fn 3.

(4) COEX-1.3 line 12.

(3) COEX-1.3 line 13.

(4) COEX-1.3 line 45.

EXHIBIT 7

SMP/SONGWRITER ROYALTIES, 2009 VS. 2020 ($000)

		2009	2020
[1]	Gross Mechanical Income[1]	RESTRICTED	
[2]	Less: Interactive Streaming Mechanical Revenues[2]		
[3]=[1]+[2]	**Total Royalties from Digital Downloads/CDs**		
[4]	Total Royalties from Interactive Streaming[3,(a)]		
[5]=[3]+[4]	***Total Royalties (DDs/CDs/Interactive)***		
[6]	Other Royalties		***not produced***
[7]=[5]+[6]	**Total Royalties (DDs/CDs/Interactive/AV)**		***Unknown***

Note:

(a) Thomas Kelly, Global Chief Financial Officer of SMP, explains that SMP's fiscal year end is March 31, and thus, most of calendar 2016 falls in fiscal year 2017, calendar 2017 falls in fiscal year 2018, and so on.

Sources:

(1) COEX-4.7 line 8.

(2) COEX-4.8 line 8.

(3) COEX-4.10 line 15.

EXHIBIT 8

WARNER/CHAPPELL/SONGWRITER ROYALTIES, 2009 VS. 2019/2020 ($000)

		2009	2019	2020
[1]	Mechanical Royalties from CDs (Physical Sales)[1]	RESTRICTED		
[2]	Mechanical Royalties from Digital Downloads[2]			
[3]	Mechanical Royalties from Mobile Digital[3]			
[4]=[3]+[2]+[1]	**Total Royalties from Digital Downloads/CDs[4]**			
[5]	Mechanical royalties from interactive streaming[5]			
[6]	Performance royalties from interactive streaming[6]			
[7]=[5]+[6]	**Total Royalties from Interactive Streaming**			
[8]=[4]+[7]	***Total Royalties (DDs/CDs/Interactive)***			
[9]	Other Royalties		not produced	
[10]=[8]+[9]	***Total Royalties (DDs/CDs/Interactive/AV)***			

Sources:

(1) COEX-6.2 line 22.

(2) COEX-6.2 line 101.

(3) COEX-6.2 line 113.

(4) COEX-6.5 summing lines 6 through 8.

(5) COEX-6.2 line 125.

(6) COEX-6.6 tab "2019 Digital" summing Apple, Amazon, Google, and Spotify for digital direct and digital non-direct. I understand Pandora became an interactive streaming service with the launch of Pandora Premium in March 2017. Thus, a portion of Pandora's royalties should also be included in performance royalties from interactive streaming services, however, Warner did not produced the necessary data to determine this amount. Therefore, total royalties from DDs/CDs/Interactive/AV is understated from fiscal Q4 2016 through Q4 2020 (Warner's fiscal year ends June 30).

Proof of Delivery

I hereby certify that on Tuesday, May 03, 2022, I provided a true and correct copy of the Apple's Notice of Errata for Written Direct and Rebuttal Statements - PUBLIC to the following:

Pandora Media, LLC, represented by Benjamin E. Marks, served via E-Service at benjamin.marks@weil.com

Warner Music Group Corp., represented by Steven R. Englund, served via E-Service at senglund@jenner.com

Powell, David, represented by David Powell, served via E-Service at davidpowell008@yahoo.com

Zisk, Brian, represented by Brian Zisk, served via E-Service at brianzisk@gmail.com

Johnson, George, represented by George D Johnson, served via E-Service at george@georgejohnson.com

Amazon.com Services LLC, represented by Joshua D Branson, served via E-Service at jbranson@kellogghansen.com

Joint Record Company Participants, represented by Susan Chertkof, served via E-Service at susan.chertkof@riaa.com

Copyright Owners, represented by Benjamin K Semel, served via E-Service at Bsemel@pryorcashman.com

Sony Music Entertainment, represented by Steven R. Englund, served via E-Service at senglund@jenner.com

UMG Recordings, Inc., represented by Steven R. Englund, served via E-Service at senglund@jenner.com

Google LLC, represented by Gary R Greenstein, served via E-Service at ggreenstein@wsgr.com

Spotify USA Inc., represented by Joseph Wetzel, served via E-Service at

joe.wetzel@lw.com

Signed: /s/ Mary C Mazzello